CHAIR'S LETTER TO SHAREHOLDERS

Results and Dividend

Despite the coronavirus (COVID-19) pandemic and a much smaller amount of property sales revenue, overall revenue increased slightly to HK$8,973 million for the year ended December 31, 2020.

When excluding the property revaluation loss and related effects, underlying net profit attributable to shareholders fell by 6% to HK$4,201 million. Underlying earnings per share decreased similarly to HK$0.93. With property revaluation loss accounted for, net loss attributable to shareholders was HK$2,571 million. Loss per share was HK$0.57.

The Board recommends a final dividend of HK59 cents per share payable on May 20, 2021 to shareholders of record on May 6, 2021. If approved by shareholders, total dividends per share for the year ended December 31, 2020 will be HK76 cents.

Business Review

September 13, 2020, marked the Hang Lung Group's 60th anniversary. That day, our Executive Director Adriel Chan assumed the vice chairmanship of this Company and of our parent Hang Lung Group Limited. This is part of the succession plan which began a decade ago. It is on track and working well. The eldest grandson of our founder Mr. T.H. Chan, Adriel is the first and only of his generation of the founding family to serve in management, just as I am in my generation. So far, he has proven himself to be a worthy successor to that name.

In his new capacity, Adriel will separately offer his perspective on key issues that impact the Company. As a 38-year-old, he will naturally have a different take on many things than I. Like many of his generation, he is passionate about ESG (Environmental, Social and Governance) issues and is more savvy with technology. Among his other duties, he is tasked with reconstituting the Board. We have excellent non-executive directors today but, as is true of all organizations, the passage of time requires new blood. It is our hope that moving forward, our Board will be more inclusive yet equally effective. This task is of paramount importance.

With Adriel sharing the burden of reporting to shareholders on this platform, I will likely not write as much as in past years. But between the two of us, the quality and quantity of information conveyed will hopefully be richer. Over the years, some of you have told me how much you have appreciated these semi-annual letters. I thank you most sincerely and trust that you will like our new format as well. Personally, it will be a relief – I do not have to write as much – and the conscientious analysts who dutifully plow through my long letters every six months, may also find reprieve.

In my 30 years of writing to shareholders, I have seldom experienced such chaotic times as we face today. It is not that the past decades were always calm and quiet. On the contrary, times have been extraordinarily turbulent, yet there is something different this time.

CHAIR'S LETTER TO SHAREHOLDERS

Ronnie C. Chan
Chair

When I first took over the chairmanship in January 1991, Hong Kong was still suffering from the aftermath of the Mainland's social turmoil of the summer of 1989 when unrest engulfed some 77 cities. We have not yet invested there at the time, but trouble had spilled over to our city. Merely months later, the unfolding drama of the fall of the Berlin Wall in November 1989 told everyone, even at the time, that the world would never be the same again. It was indeed a fateful year.

On July 1, 1997, Hong Kong returned to her Motherland after over 150 years of colonial rule. Little did anyone know that the next day, we would witness the beginning of the Asian Financial Crisis (AFC). Its direct effects lasted some five years. During that period, we had to face the Y2K issue, followed by the burst of the tech bubble. The year after the AFC ended, SARS hit our part of the world in 2003, and the epicenter was actually at one of our developments called Amoy Gardens. Today, we still own its shopping mall.

In 2008, the world was confronted with the Global Financial Crisis (GFC), the severity of which humankind had not seen for three quarters of a century. If it had not been arrested in time, one further step in the wrong direction might have brought upon a global economic collapse and not just a financial one. Thank God that China was spared and undertook resolute actions that helped the world avert the worst. In fact, since joining the World Trade Organization (WTO) in 2001, China has gradually become the most important economic engine of the world.

Here in Hong Kong, our social cohesion has deteriorated substantially as evidenced by the increase in violence during the three major periods of social turmoil in 2003, 2014, and 2019. Endless political wrangling has led to economic malaise. A commercial city has turned into a political jungle.

That brings us to the triple whammy of today – fast deteriorating China-U.S. relations, the 2019 riots in Hong Kong, and COVID-19. They came all at once. Relatively speaking, the issues of past decades seemed to be either short-lived (like SARS), insignificant (like the tech bubble), recoverable (like AFC and GFC), or even outright beneficial to our business (like the perceptions surrounding Hong Kong's return to Chinese rule). Once each had run its course, the market seemed to recover as if little had happened.

Not so with the present three issues. The Hong Kong social unrest of the second half of 2019 has inflicted a serious blow to our economy. COVID-19 has changed the world for good, and America's present actions against China have thrown the bilateral relationship back to before U.S. President Nixon's China visit of 1972. Having written extensively on these issues in this letter of the past two years, I will only offer a few further thoughts on each.

Hong Kong's economic future is bleak. There is nothing in sight that can reverse the trend. Moreover, there are a few almost insurmountable obstacles which, unless removed, will ensure economic lethargy. No one could have damaged this city except its own citizens. It is indeed sad. The National Security Law (NSL) instituted on June 30, 2020 not only is not the cause of our demise, as some in the West assert, it is an absolute necessity to save Hong Kong. However, even if peace is restored – and so far it has been – the economy is crippled. The 50 million or so annual Mainland tourists will not come back any time soon even after the pandemic. Without the NSL, they did not come because of the risks to personal safety. But even with the NSL, the feelings of Chinese citizens toward our city have already turned from admiration to disdain, if not disgust. So why would they come!? It will take some time before they would return en masse.

Comparing the sentiments of Hong Kong people and Mainlanders toward each other is revealing. Before the Occupy Central movement of 2014, the average Mainland citizen admired us. The primary reason was our higher standard of living, and, secondarily, our freer and fairer society. For those with children, Hong Kong offered more choices of schooling. Wealthy Mainlanders also liked our low tax regime, and many of them moved here.

Since 2014, the situation has significantly worsened. Former peaceful demonstrations deteriorated into outright violence. The social unrest that year was terrible, but the one in 2019 was far worse. Its horror was worse than the scenes at the U.S. Capitol earlier this month, except that Hong Kong's police force was far more restrained. It lasted one day in Washington, D.C. and seven months here. It was confined to one building there, albeit a very important one; in Hong Kong, it was on the streets everywhere.

Meanwhile, our economy has been lethargic – far from reaching its potential, given the tremendous opportunities just across the border. The single biggest reason for this stagnation is the politicizing of government decision-making. A prime case is the handling of land supply. It was the politicians who prevented land sales. In fact, politics brought the government to a standstill. A simple public expenditure bill in the Legislative Council would take over a year and still without any resolution. How can the economy survive?!

All along, the Chinese economy has kept advancing. Our average citizen is today no longer that much wealthier than those of major cities up north. In fact, many of the former, watching how Mainland tourists spend money here, have had their unfounded superiority complex seriously dented.

Consider these statistics from the World Bank. In 1997, our GDP was almost 20% that of the Mainland; in 2019, it was 2.5% and the number is shrinking fast. Back then, their per capita GDP was less than 3% of ours; 22 years later, it was over 21% and kept rising. Over that period, their GDP climbed annually at 12.4% while Hong Kong's grew 2.7%. Direct comparison between the two is not that meaningful, since theirs began at a low base. Nevertheless, the question for my fellow citizens is: being so close to the Mainland and with Beijing willing to economically support us, why have we grown at such a slow pace since 1997? Something must be wrong with us. If we had played our cards right, it would not surprise me if we had grown at an annual rate of 4%-5%.

Given the human frailty to which we are all subject, Hong Kong people's lost superiority complex in economics found expression in politics. Some of our citizens touted the superiority of our political and social system. Contrary to the Basic Law, they pushed for a purely Western political model. I happen to believe that what is guaranteed by the Basic Law is the most befitting for our city, for we are not a nation state. Sadly, the opposition wants to dismantle it. How foolish, just as thoughtful Westerners are reexamining the serious weaknesses of their own systems. Just look at the U.S. of recent years.

Unfortunately, the local anti-government faction was emboldened by Western politicians at a time when the latter had decided to turn China into an outright enemy. Hong Kong became a pawn in the international chessboard. What the opposition once trumpeted as peaceful demonstrations soon degenerated into extreme violence. Our society and our economy were both crippled. This forced the hand of Beijing and so the NSL was born.

The fact that such a law had to be instituted meant that Beijing had lost the challenge of taking back Hong Kong successfully. For 23 years, they tried to placate our citizens without understanding them. Coupled with the political immaturity of the local opposition, Beijing had allowed itself to be pushed to a corner where only the NSL could reverse the slide into anarchy.

How, then, does the average Mainland citizen see Hong Kong now? If their netizens are any indication, then the perception is highly unfavorable. To be sure, it is difficult for them as patriots to understand the socio-cultural history of this city, which renders its people devoid of national identity. Mainlanders are baffled by the fact that in spite of the many privileges bestowed on Hong Kong (such as not paying the share of the military budget relating to our defense, as well as many economic policies that specifically benefit us), her people should oppose the Central Government so violently. Why do you bite the hand that feeds you, they have rightly asked. The disbelief has led even some Mainland people who have lived here for decades to relocate back north. This is not an encouraging development.

These are worrying signs for Hong Kong and for our local business. After all, over 40% of our total rental income still comes from this city. Our economy will not disappear but neither will it thrive.

As I wrote last year, whereas COVID-19 is a bane to our Hong Kong rental business, it is a boon for us on the Mainland. With the cessation of almost all international travel, and with Chinese tourists and luxury good shoppers not as welcomed in the West as before, almost all such sales now transact inside China, excluding Hong Kong. In the past six months, a top luxury brand which had performed poorly in our malls saw its sales doubled. The better ones grew as much as three times.

Over the past six months, more and more people have come to believe that humankind has to coexist with COVID-19 for longer than previously hoped. Even with the new vaccines out and if everyone continues to observe social distancing, it is possible that the virus may still pose a serious threat to the world for at least another one to two years. Imagine what that will do to the global economy and to society. In the short term, high unemployment will remain, and the wealth gap will widen. For that alone, we will likely see a lot more social unrest, especially in democratic as well as in poorly run autocratic countries. Hopefully, better managed autocratic or semi-autocratic nations like China and Singapore will fare better.

Governments everywhere will have to keep printing money to the greatest extent possible in order to prop up their economies and blunt the effects of unemployment. Longer-term inflationary pressure will, for now, be overlooked. However, asset inflation will be immediate – as witnessed by gold prices for much of last year, and by stock market indices reaching new heights everywhere. The stage is being set for another fall, perhaps not unlike 2008. If it coincides with yet another global public health scare or serious geopolitical crisis, the consequences will be dire.

A year before his death, I showed the former German Chancellor Helmut Schmidt in late 2015 a list of eight global problems. All of them will hit humankind, and the timing of any of them striking is unknown. All are unavoidable. He examined the list and said: number three – pandemics. Viruses and bacteria have coexisted with us for a very long time. In the past few centuries, they burst upon the scene once every five or ten years somewhere in the world. Because the globe then was not half as connected as it is today, plagues spread much slower and were often contained in one region of the world. Epidemics did not easily become pandemics.

Not so today. Moreover, due primarily to the rapid and ill-planned urbanization almost everywhere in the world, the frequency of such epidemics or pandemics has shortened to once every one to two years. Together with global travel and the asymptomatic nature of some of these diseases, the destruction of life by such age-old enemies can quickly spread across the globe. Improved medical and especially public health conditions have greatly lowered the death rate, but their infectious nature does spread fear to a much greater percentage of the globe as we have witnessed of late. Moreover, pandemics are a race between humans and nature, where we find ourselves in the light and the microbes in the dark, mutating with such efficiency as to outpace our ability to develop vaccines and cures.

COVID-19 has amply shown that the form as well as quality of government are both critical to keeping the pandemic relatively under control. The form of any government is in turn related to the culture of the communities it governs. A more hierarchical society like those in Asia coupled with a competent government will have a better chance of avoiding the worst onslaught. That said, no one can ever claim victory over nature. Only fools do.

China's relative success in containing the pandemic is a critical factor for Hang Lung's acceptable performance last year. In spite of a rather weak Hong Kong commercial rental market, overall we did reasonably well because the Mainland economy, and in particular its luxury retail sector, performed well. In face of trouble everywhere, China remained a relatively calm place with a reasonably strong economy. Companies doing exactly what we do but operating in other countries, either developed or developing, may not be as fortunate. Theoretically, price earning ratios should reflect those favorable external factors.

Now let me turn to the third and final major issue that is having serious repercussions on our business, namely deteriorating China-U.S. relations. As we all know, America has publicly pronounced China her number one enemy. This necessarily implies the return of the Cold War. The last one ended about 30 years ago when the Soviet Union collapsed. In the interim, China gained strength as did the neoconservatives (or neocons) in the U.S., the two factors causing the troubled relationship today.

China's Reform and Opening Up Policy, initiated in 1978, aimed to achieve economic development. Decades of political upheavals culminating in the Cultural Revolution of 1966-1976 had left the country poor and backward. Under the capable leadership of Mr. Deng Xiaoping, China undertook a humongous social and economic experiment. Fortunately, it scored a huge success.

Many in the West watched with skepticism. They said that without a political system that is in line with Western values and structure, it could not succeed. They were disappointed. Then they said that once the Chinese gained some wealth, they would be molded into the Western image. That too was proven inaccurate. Thankfully, not all in the West held these views. As Dr. Henry Kissinger pointed out long ago, for millennia, the ancient land of China was culturally and economically the most advanced in the world. Consequently, it should not be presumed that China has to do things the Western way to thrive again.

Concurrently, the U.S. was witnessing the resurgence of neoconservatism. Using then U.S. Under Secretary of Defense Paul Wolfowitz's 1992 paper, later known as the Wolfowitz Doctrine, as a convenient starting point, this neoconservatism asserts the following: that the U.S. will preemptively and, if necessary, unilaterally prevent any country from becoming a close number two that may threaten American interests. Initially the idea was condemned as nothing short of American imperialism. When George W. Bush became U.S. President in 2001, however, it gained strength. With Donald Trump in the White House, the doctrine reached new heights.

As China gained economic strength and began to play an increasingly prominent role in the international arena – primarily selling manufactured products overseas and buying therefrom natural resources including energy and food – the U.S. became worried. Competition in many areas of the world became inevitable. American suppression tactics were often met with China's countermeasures. Frankly, the U.S. had never met such a formidable competitor, for the former Soviet Union was never an economic match. Uncle Sam became increasingly insecure.

U.S. President Trump fully subscribed to the Wolfowitz Doctrine and sought to stretch it to its limits. The truthfulness or falsity of any issue was no longer significant. In the presence of a perceived national threat, true or false, just win the battle for the day. With international press on his side, President Trump has convinced the majority of Americans and some in the West that China is now the number one threat to the world. The truth is that China is not a threat to the world. She may be threatening the monopoly of the U.S. in some areas, but to be a threat to the world and to be a threat to American monopoly are two totally different things.

Having been the undisputed leader of the world since the fall of U.S.S.R. some 30 years ago, America is unwilling and probably unable to work with the number two as friends, whoever it may be. Its cultural Judeo-Christianity roots only recognize black and white – heaven and hell, God and the Devil, and salvation and perdition. By demonizing China, the U.S. becomes the incarnation of righteousness. Truthfulness matters little; what America says must be correct.

This to me is the chief legacy of the Trump administration in the international arena. In so doing, the alleged China threat has been elevated domestically to the level of national security. That way, any incoming Democratic administration will not dare to appear to be weak on China. It will not be easy for U.S. President Biden to climb down from that adversarial stance, although the rhetoric and strategies may be less confrontational. After all, today, almost half of all Americans still voted for President Trump's extreme positions. The longer this adversarial relation lasts, the more it is cast in iron. This is why I believe that what is happening today between the two countries is a systemic change rather than a mere cyclical fluctuation. The chances of China-U.S. relations soon returning to the days of the 1970's and 1980's are, in my opinion, very slim.

How long this turbulence in relations will last is unbeknown to all at this time, but reviewing history may yield some clues. China-U.S. relations were bad since 1949 at the founding of the People's Republic of China. The Korean War which started only months later sealed that fate, until President Nixon's visit in 1972. That was a long winter of some 23 years. The two suddenly became friends primarily due to the perceived threat of the U.S.S.R. to both countries. However, the 1989 social unrest in China marked the beginning of strained relations once again. Later that year, the fall of the Berlin Wall, which symbolized the end of the Eastern Communist bloc in Europe, took away the primary reason for the U.S. to work with China. Friendliness was replaced by ambivalence on the part of Washington. By the time President Biden was sworn in earlier this month, the erosion of the relationship had been ongoing for over 30 years. All the while, neoconservatism had deepened its hold on America.

Such is the history as I see it. An adequate understanding of China-U.S. relations is critical to businesses anywhere in the world, and certainly includes ours. When the number one and number two elephants fight in a room, all suffer. Worse is the fact that it is a contest that neither side can win. Since, by definition in a Thucydides Trap, it is the existing number one which initiates the conflict, one would expect that the U.S. knows exactly what her game plan is and what her ultimate achievable endgame is. Surprisingly, I have yet to hear a thoughtful explanation of either from anyone, least of all from the American policy community. As such, I can only assume that American intentions are to slow down the development of China. That can be done, but what if, in the end, your opponent only becomes stronger? I believe that the U.S. is today unnecessarily creating for herself a formidable counterparty. I do not see how that can be to the benefit of the U.S. or of anyone else.

These days we hear a lot about how President Biden will re-engage the country's traditional allies, especially those in Europe. I find that incredulous. The relationship between two countries works the same way as between two persons. Considering the way the U.S. treated her friends, especially since the end of the Cold War, it is audacious to think that she can turn on and off bilateral relations at will. Would former allies trust you as before? From the 1950's to the 1980's, yes, but today? I am not so sure. To say that the new administration will work with allies again, as if nothing has happened, is to be totally devoid of the ability to self-reflect and is disrespectful of others' feelings. Today, many of America's traditional allies may well feel that they have been mistreated once too many.

No doubt China will suffer as a result of America's attacks today. But all things considered, the ancient nation should be able to remain standing. Knowing the Chinese psyche, outside threats will only rally her citizens around their leaders. Moreover, as long as Beijing manages her domestic affairs acceptably, her economy should advance further. Given her governance structure, China may in the coming decade or two be one of the more peaceful places of the world. Her economy will likely outperform most if not all major countries. Reform will proceed but not necessarily along the lines of the Western model. For example, I question if Beijing would or should any time soon open up her currency on the capital account basis.

If my assessment of the situation is not too far from the truth, then Hang Lung can count itself fortunate to have been well positioned. Over the past decade or so, annual growth rates in Western economies have hovered around 2% as opposed to China's 9%. The latter's continued advance will increasingly rely on personal consumption, which should benefit us greatly. After all, given deglobalization, export as a percentage of GDP may fall slightly. In most advanced economies, household consumption as a percentage of GDP is around 65%. For China, it is barely 40%. There is much room for increase. Moreover, growth in the market for luxury items, like those sold in our facilities, should outpace growth in general consumption.

Plaza 66, Shanghai

Before projecting more specifically into what our future may be, let me first report on our performance in the past year. Hong Kong commercial rental was feeble, although there is reason to believe that we have outperformed the market. From the already weakened rental level after the 2019 social unrest, the pandemic has further pushed rents down. As a result, we collected 9% less than the year before. The effects of rent relief that was necessary to keep our facilities more or less full will continue to play out in the coming two to three years. I believe that the rental heights achieved in 2019 will unlikely return for a very long time.

On the Mainland, every segment of our business improved during the second half of the year although the pace of growth differed greatly. The outperformance of luxury shops reported at mid-year has continued unabated. During the last six months of the year, tenant sales and rental revenue of sub-luxury malls finally approached pre-COVID-19 levels. On a year-on-year basis, our five-star malls did better than 2019 but not so for our four-star properties.

Here, let me make a very important distinction. It must be understood in order to properly analyze our business.

When we bought the two pieces of land in Shanghai in the early 1990's, our plan for one, now Plaza 66, was to be a luxury facility, while Grand Gateway 66 was meant to be sub-luxury. The two surely became leaders in their respective markets in the city. There was always the hope that one day Grand Gateway 66 would be upgraded. Because our hardware was originally designed and built to top specifications, it could be done once the market allowed. Such was the case, and the Asset Enhancement Initiative (AEI) completed last September enabled us to take advantage of it. Higher rents commensurate with its five-star status were the prize. It was very satisfying.

Given the early success of Plaza 66, as far as possible we aimed for luxury status when we purchased land outside Shanghai beginning in 2005. In some cases, we knew beforehand that the location was not a five-star one, such as Palace 66 in Shenyang, which was destined to be sub-luxury. All other plots we bought can go either way depending on market conditions and the local competitive landscape. Both factors can change over time.

Between 2010 and 2015, we inaugurated six complexes on the Mainland of which two also have an office element. Our expectation was that at least three of the six malls would be of the luxury kind. Because the bear market for high fashion and accessories descended upon mainland China in mid-2011, our plans were put on hold for the duration, which lasted six to seven years. But our intention never changed. In early 2018, the market finally turned. As originally envisioned, three of the six malls are now in the luxury category. Of those three, Center 66 is the undisputed leader in Wuxi, and Olympia 66 is becoming so in Dalian.

Our latest to open is Spring City 66 in Kunming; it is now 17 months old. No one can deny that from day one, it was the king of top-end malls in that city. In March this year, the Heartland 66 mall in Wuhan will open for business. Examining the tenant list will convince anyone that it too will dominate the high fashion market in this biggest city in central China. Given that, seven of our ten developments so far will be of the luxury kind. Of the remaining three, two will still have a chance to one day rise to elite status, although it may be a few years down the road.

During the six-and-a-half-year bear market for luxury goods, our retail rents across the board was hurt, especially the newer properties which all happened to be outside Shanghai. As such, some investors questioned our ability to repeat the magic of Shanghai. The divide to them was Shanghai versus non-Shanghai. But your Management knew better. We were convinced of what would happen once the market turned. Now three years into the recovery, what we had expected all along has come to pass. Our malls built for luxury brands have attracted all the top names to be our tenants. Consequently, rents have risen significantly.

The divergence in performance between luxury and sub-luxury malls was most apparent during the pandemic in the first quarter of 2020 as well as afterwards. The five-star properties outside Shanghai performed exactly in line with the two in Shanghai. The four-star centers were clearly in a different category. The following year-on-year figures amply illustrate the point. (Over the past year, Olympia 66 in Dalian was under transition when many high-end brands were moving in, so its overall performance was still predominantly that of a sub-luxury mall. This was why we temporarily classified it as such.)

During the first quarter of 2020 – to be exact, during the two months of February and March – business was severely affected by the onslaught of the pandemic. By April, we clearly saw a recovery in luxury goods sales while other product sectors remained slow. For the second half of the year, sales of the former exploded. Other items also recovered but at a much slower pace.

Comparing Shanghai versus non-Shanghai performance in retail sales gives a very different picture from comparing five-star versus four-star mall performance. (The non-Shanghai numbers are a combination of luxury and sub-luxury malls.) For the first half of 2020, our two Shanghai facilities did 15% more business than in the corresponding period of 2019, while those elsewhere did 7% less. It was a swing of 22 percentage points. In the second half, the respective numbers were up 90% versus up 49%, a difference of 41 points. But if we compare our luxury versus sub-luxury malls, the real situation becomes much clearer. In the first half of 2020, the former rose 21% but the latter fell 34%, a gap of 55 points. For the second half, luxury malls did 98% more business while the others remained 4% below sales figures of the year before. The difference was a gaping 102 points.

Spring City 66, Kunming

All these clearly tell us that our five-star properties outside Shanghai behaved exactly like the two in Shanghai. In fact, most of the former outperformed Plaza 66 and Grand Gateway 66 in tenant sales. This was true on a year-on-year basis, as well as when comparing the second half to the first half of the year. Please be mindful that the growth in Shanghai was already extraordinarily strong – for Plaza 66 and Grand Gateway 66, the climb was 60% and 42% year-on-year, and 95% and 86% second half to first half, respectively.

These statistics put to rest any doubt about our ability to create value outside Shanghai. With the continued strong growth of Center 66 in Wuxi and Spring City 66 in Kunming, the upgrading of Olympia 66 in Dalian to five-star, and the opening this March of the Heartland 66 mall in Wuhan, such properties, together with our two in Shanghai, will become the twin engines for our growth.

Another landmark event in the past year relates to the relative weighting of the Mainland and Hong Kong for our property leasing business. In 2019, the Mainland accounted for 53% of the total rental revenue; Hong Kong was 47%. The former edged up to 54% in the first half of 2020 but jumped to 63% by the second half. The full year numbers were 59% Mainland and 41% Hong Kong.

Rental operating profit followed a similar trend. In 2019, the split was 46% Mainland and 54% Hong Kong. For the first half of 2020, the former stood at 49%, but due to strong recovery in the second half, the number soared to 59%. For the full year, it ended at 54% while Hong Kong accounted for 46%. Anticipating continued market strength up north and lethargy locally, the differential may yet widen this year.

Our Mainland offices, meanwhile, performed acceptably. As I have written before, oversupply in almost all major cities is tremendous. Unless location, design, construction, and management are all superb, high vacancy rates are inevitable. Fortunately, our products are invariably among the very best in all these measures. As a result, filling them up should not be a problem, but a significant rise in rent will be difficult. As part of a comprehensive development, offices serve to enhance the prestige as well as supply quality footfall for the mall below, while yielding reasonable returns. Our Mainland offices have undoubtedly achieved this goal.

In Shanghai, our offices maintained an occupancy of 93%. More mature buildings outside are between 85% and 90% full. The 17-month-old second tower in Center 66 in Wuxi is already 52% occupied while the number for the skyscraper in Spring City 66 in Kunming stood at 41% at year-end. Even the office tower at Heartland 66 in Wuhan, which opened only two months ago, is now 15% leased. I expect the occupancy of all office blocks to rise in the coming year.

Center 66, Wuxi

The situation in Hong Kong is not encouraging for all commercial properties. Our outperforming the market is hardly a comfort. Retail sales of our shops went down 20%, which must be better than the average for the city. Rental revenue therefrom fell 10%. The negative effects of rent relief previously granted are still working their way through while new grants may still have to be added. On the Mainland, by April of last year, retail sales and rental revenue for all our properties already exceeded those of the same period in 2019. But in Hong Kong, both measures stayed throughout the year below the same numbers of the year before. This is not to mention that 2019 was already a pretty weak year, mainly due to the social unrest.

Hong Kong office rental also came under pressure last year. We collected 6% less rent. Worse yet, the situation deteriorated as the year wore on.

Given COVID-19, no one should be surprised by the sizeable revaluation loss. In the second half of the year, Mainland luxury malls recovered strongly, so the loss was smaller in the last six months. All in all, the net revaluation loss of HK$6,772 million for the year equates to 3.6% of the value of our entire investment property portfolio. There was no change to cap rates.

Excluding this non-cash item, profit was actually up by 2% compared to the year before. On the Mainland, our rental business brought in 18% more profit than in 2019. Hong Kong rental operating profit was 12% lower. We also sold fewer development units and so made 15% less locally. Taking other items like interest payments into consideration, overall underlying profit attributable to shareholders was down 6% to HK$4,201 million.

Net gearing at year-end stood at a healthy 21.3%. Barring unforeseen circumstances such as land acquisition or the sale of investment properties, net debt should peak in 2023. Much of the outgoings of late are for construction of new projects. When good opportunities arise, we do not mind adding to our land portfolio, especially on the Mainland.

My readers in many parts of the world may find it incredible that so much activity should be ongoing at our Company during this global pandemic. Because China has handled the threat relatively well, business is more or less back to normal. In the addendum to my letter to shareholders a year ago, I was concerned if workers travelling home for the Chinese New Year in 2020 would be able to return to Wuhan afterwards. Eventually they could not do so because of the citywide lockdown. That caused a delay of about six months to the construction works at Heartland 66 in Wuhan. This year, for all our new Mainland developments, there is less worry since the Central Government has strongly urged workers not to travel home for the festive season. Nevertheless, due to last year's problems, we are still trying to catch up at Westlake 66 in Hangzhou. Hopefully phase one can still open in 2024 as originally planned.

The mall at Heartland 66 in Wuhan will open on March 25. Over 80% of the space has been leased. More significantly, almost every top brand we wanted has signed up. It will be the city's "Home to Luxury" from day one. Once open, I expect brisk business. The office tower is leasing satisfactorily. Circumstances allowing, we hope to presell the apartments next year.

We are witnessing the final phase of the transformation of Olympia 66 in Dalian from a sub-luxury to a full luxury mall. Many of the world's most desired tier-one brands have already moved in and more will follow. The process should be concluded by the end of this year. Phase two, accounting for 13% of total space, will also be fully operational soon. It is fast becoming the city's most sought-after luxury shopping center. Full-year impact will be felt in 2022.

Similar to what was undertaken in recent years at Plaza 66 and Grand Gateway 66 in Shanghai, a major AEI is being planned at Parc 66 in Jinan. It was our second property on the Mainland to open outside Shanghai and is now a decade old. It has always performed well with great footfall and retail sales, so also rental income. In order to maintain competitiveness, this is the right time to upgrade. Hopefully the result will approach the extraordinary successes of the two Shanghai developments.

Heartland 66,
Wuhan

In Hong Kong, we hope to presell, as early as the second half of this year, the residential units on the former Amoycan Industrial Centre site. Construction there and in the office building on Electric Road are proceeding as planned. Occupancy permits are expected respectively in the first half of 2023 and of 2022.

Last September we won a land tender in Shouson Hill, a highly desirable residential address on the south side of Hong Kong Island. It is the first time in 20 years that we have won a local competitive bid. Our rationale is simple. Of all property types in our home city, true luxury housing is the only one that we are interested in. Supply is limited and demand will always be there. Moreover, profit margin can be rather elastic, which means that if we get the timing and the product right, such projects can be very lucrative.

My pessimism of late for Hong Kong's economy should not be new to those who follow our Company. The 2019 social uprising has fundamentally altered our future. It is probably correct to say that we have managed to alienate at least 90% of Mainland citizens to one extent or another. They do not understand why so many Hong Kong people have such a strong aversion towards their Motherland. The reality is that only a minority in Hong Kong feels that way. As I have written before, the majority may dislike the present Hong Kong administration because of its incompetence. That ill feeling can unfortunately be accrued to the Central Government. It means that as long as Beijing is not foolish in the future to support poor leaders, the hearts of Hong Kong people can to some extent be regained.

Now with the NSL in place, tranquility has been restored to our streets. It is unlikely that riots will return any time soon. It buys time to fix the various broken aspects of our society. In the meantime, effort will be deployed to slowly foster national identity in Hong Kong people, which has been missing for a century and a half. All along, our economy, backed by Beijing, will chug along. It will not be vibrant, but neither will it die. Hong Kong can still make meaningful contributions to the country. I see no incentive for Beijing to hurt us. Hopefully our economy will increasingly integrate into that of the second largest in the world, just north of the border. This is something that I, like other rational people here, have long advocated. Anyone objective and knowledgeable, who wants to see Hong Kong thrive, will easily come to that conclusion.

After all, Hong Kong still holds some attraction for many Mainlanders, including the sizeable cohort of the seriously wealthy. It is an open society which welcomes outsiders and poses no difficulty in settling in for even those unfamiliar with the local dialect (Cantonese). For example, in the past decade or two, an increasing number of younger Westerners have made Hong Kong their home. Their employment ranges from professionals and blue-collar workers to entrepreneurs. The many cafés and bars that some of them have opened have enriched our community life. My physical therapist, for example, is from Australia, and a friend's security guards for his luxury events are from Africa and the U.K. As long as they are law-abiding, we welcome them here!

Then there are the truly wealthy from wherever. They like our low tax rate, our superb physical and digital connections to the rest of the world, and our proximity to the huge Chinese market. Now that Hong Kong is on the mend, as far as her relationship with the Mainland is concerned, many of the superrich from there would still like to own a home in Hong Kong. Recently, a Shanghai friend who has lived here for over two decades complained to me that he and his wife and two teenage daughters found their 600-square-meter home too small – now that is a lot bigger than my home! – and are looking for a 1,000-square-meter house. Well, I have just the right address for them!

There is another reason we tendered for the Shouson Hill land – market sentiment was very weak due to the recent social problems and the pandemic. Our track record of the past three decades clearly demonstrates that we are a bottom fisher for top jewels. As I have always told investors, expect Hang Lung in the market only when there is blood in the streets. True to form, we bid, and we won.

Such a strategy requires patience – sometimes a lot of it – and patience we have aplenty. When we won the public auction 20 years ago for the land on which The HarbourSide now stands, there was only one other bidder. This time we apparently had four, including the one who competed with us two decades ago. Some believe that The HarbourSide is the single most profitable real estate project Hong Kong has ever seen. I do not know if this is true, but it should not be too far from the fact. Interestingly, one of our competitors in the present bid immediately rang me after we won. He asked if we would allow them in as a joint venture partner. People who know me would know the answer – I do not wait 20 years to share the fruit. After all, we are financially strong, and the project is not too big for the size of our Company. Moreover, the piece of land is attractive as is the price. I expect the eventual profit to be equally pleasing.

On this plot of 8,800 square meters, we can construct some 4,400 square meters of luxury houses. Our winning bid of HK$2.566 billion equates to approximately HK$583,000 per square meter of buildable space. This compares very favorably to a slightly bigger piece of land right next door, bought in 2018 by a Mainland company. They paid HK$924,000 per square meter or almost 60% more than us. Ours has a beautiful and full sea view as well as simple lease conditions from the government. Theirs has no sea view and stifling building restrictions to boot.

Our transaction was scheduled to close on December 30, 2020. However, subsequent to winning the tender, we have learned that the seller, which is a foreign sovereign state, has yet to apply to Beijing for approval to sell in accordance with established diplomatic protocol. As a result, we cannot consummate the deal as stipulated and have to wait for clearance. Knowing somewhat the situation, I firmly believe that there is no reason the transaction cannot proceed soon. In today's low interest rate environment, the 10% down payment can be considered as option money for a superb plot of land at very reasonable price. Frankly, the piece is almost one of a kind, and I believe that the option only needs to be short-dated.

If we see other excellent plots at similarly attractive prices, we would not hesitate to try again.

Prospects

In Hong Kong, apart from the luxury residential market, it is highly doubtful that we will invest in other property sectors. We may even continue to sell some mature investment buildings. However, there is no need to rush into any decision. We will continue to observe the political, economic, and market situations as they evolve, and will as always keep investors informed as appropriate.

On the Mainland, we will, as before, continue to search for further land opportunities. We are studying several metropolises and also do not mind expanding in certain cities where we already have a presence. We continue to see the Mainland as a desirable place to invest in four- and especially five-star malls. We may even experiment a little with product types when circumstances call for it. As always, we will err on the side of caution.

For 2021, I anticipate continued recovery in retail spending on the Mainland. Luxury fashion and accessories should still be a top performer. However, since the 2020 growth rate has been so strong, percentage increases this year may be milder. Sales of other goods should recover to and beyond the 2019 level.

Olympia 66, Dalian

Our two Shanghai facilities should still turn in excellent results in terms of rental revenue. I expect Grand Gateway 66 to approach, if not surpass, Plaza 66 in terms of growth rate. Top line increase outside Shanghai should be even stronger. In particular, I will single out Spring City 66 in Kunming and Olympia 66 in Dalian to be the ones to watch. The former is at, and the latter approaching, takeoff stage. Center 66 in Wuxi, which has performed superbly in recent years, should continue to do well. Omens are good that upon opening on March 25, the mall at Heartland 66 in Wuhan will also shine.

Including Heartland 66 in Wuhan, five of the last six malls that we have inaugurated are in the luxury category. Only Riverside 66 in Tianjin is sub-luxury. The earliest of the five, Forum 66 in Shenyang has done barely acceptably, but the rest have all proven to be exciting like our two in Shanghai. I trust that the mall in Westlake 66 in Hangzhou, expected to inaugurate in 2024, will continue that string of successes.

Looking ahead, the pipeline of new properties opening in the coming five to six years should be very pleasing. Total square footage is considerable. Completion of the various projects is somewhat staggered, such that our finances would not be strained.

After opening, the maturation of a mall usually takes a few years. Due to the 2011 to 2017 bear market, that process for all our new developments was prolonged. Fortunately, the tide has turned. Since 2018, all of them have returned to a normal growth trajectory and are performing well. Even the pandemic, which is now exactly one year old and counting, has not disrupted their trajectory.

Beginning with Spring City 66 in Kunming, which began trading in August 2019, the time required for our malls to mature should be shorter. We have gained experience, including in design, and the market is auspicious. The chances of Heartland 66 in Wuhan achieving likewise seem promising. We will find out during the course of this year.

It is interesting to note that, with the exception of Plaza 66 in Shanghai, which was perhaps the country's first truly luxury mall, in all our other cities, there were already players occupying the leadership position before we came in. Tier-one and tier-two brands were already lodged elsewhere. So, when our five-star shopping centers opened for business, we had to fight for the top spots. So far, in all but one case (Forum 66 in Shenyang), we have succeeded. In those markets, we are now the undisputed leader.

Needless to say, the demand for luxury goods differs from place to place. Take Louis Vuitton for example, which can have more stores in some cities than others. For instance, Shanghai and Beijing can easily accommodate at least seven each, Hangzhou and Chengdu, four, Wuhan three, Shenyang two, etc. Many more cities can only have one. What is important to us is not just which category of city we are in, but also our market positioning in any given city. What market share can we command? It is of course best to be in a huge market like Shanghai and be the number one player. Rents derived therefrom will be super high, like Plaza 66. But if we can be the dominant player in a one- or two-store city like Kunming or Wuxi, revenue can still be quite pleasing. Whatever the case, it is obvious that unit rent will always reflect revenue generation capability.

Before examining our pipeline of new constructions, let me first briefly review the project completions of the past two years. Quietly, we had inaugurated one mall, three office skyscrapers, and a hotel, totaling approximately 613,000 square meters. Completed in 2019 were the second office tower of Center 66 in Wuxi, the mall and a high-rise office in Spring City 66 in Kunming, as well as the Conrad in Forum 66 in Shenyang. Late last year, we opened the office building at Heartland 66 in Wuhan. If we place any of them anywhere in the world, each will be considered world-class, if not the best in class.

After the opening of the mall at Heartland 66 in Wuhan two months from now, we are not expecting any construction completion on the Mainland until 2023, which will be another busy year. The apartments at Heartland 66, our first residential project outside Shanghai, should be ready for occupancy by then. So will the residential units at Center 66 in Wuxi and Spring City 66 in Kunming. In each of these last two developments, we expect to also open a hotel in the same year. The one in Center 66 will be an internationally branded boutique hotel, and details of the hotel operator will be announced later in the year. For Spring City 66, we have already appointed Grand Hyatt.

Beginning in the year end of 2024, Westlake 66 in Hangzhou should see the opening of its mall as well as some office towers. The other buildings and the hotel should be ready by 2025 or soon thereafter. In fact, we are already very close to signing with a truly first-class hotel group. It will set the tone for the rest of the project – top luxury and world-class.

As well in 2025, we plan to complete the first apartment blocks at Forum 66 in Shenyang. There will also be an extension of the existing mall. The combined retail space should enhance the customer experience. We will continue to look for the opportune time to build the second office tower.

This pipeline of new construction will keep Management busy until at least 2026 to 2027. If we buy land in the next year or two, completion of projects thereon should dovetail well with the existing inventory.

In terms of financial results, I expect the malls at Olympia 66 in Dalian and Spring City 66 in Kunming to mature in the coming two or three years, followed closely by Heartland 66 in Wuhan. Increased rents should be the result. That should bring us to around 2024 or 2025, when the retail element of Westlake 66 in Hangzhou should hit the market. The profit potential from these projects, together with our existing ones in and outside Shanghai, should be rather powerful.

In the coming few years, I anticipate the office space added in the past 18 months – Center 66 Office Tower 2, and one each at Spring City 66 and Heartland 66 – to be basically fully let. This will approximately be the time when the office blocks at Westlake 66 in Hangzhou will be ready. So far, the office market there is quite strong. We also take comfort in the fact that our location is as good as it comes. The layout and architecture of the entire project are also excellent.

In the next four to five years, we hope to sell out our Mainland apartments outside Shanghai. There should be reasonable profit as well as considerable cash flow. In the order of completion, they are Heartland 66 in Wuhan, Center 66 in Wuxi, Spring City 66 in Kunming, and finally, Forum 66 in Shenyang.

From the above narration of our Mainland rental operations, barring unforeseen circumstances, our financial returns in the next decade or so should be quite exciting.

Hong Kong rental will unfortunately remain feeble. Frankly, I will be happy if rents for the coming few years can stay at last year's level. If we sell any investment properties, total rent collection would fall but we would have monetized some aging assets. Capital appreciation compared to original cost should still be very rich.

Westlake 66, Hangzhou

Total profit this year and in the coming few years will also depend on the sale of Hong Kong assets. They will come from three sources. First, the completed development on Blue Pool Road, where we still have nine houses for sale. Two other units are for lease. Second, new projects being or soon to be constructed. These include the residential towers of the former Amoycan Industrial Centre in Kowloon Bay, the office block on Electric Road on Hong Kong Island East, as well as the Shouson Hill site, the transaction for which will hopefully be completed soon. Finally, and as in recent years, we may also part with some investment properties, many of which have been in our portfolio for a very long time.

Our long-serving Independent Non-Executive Director Mr. Ronald Arculli will retire at the coming Annual General Meeting in April. This is due to the age limit for directors set by the board years ago. I want to thank him most sincerely for the long years through which he has guided this Company. He joined the Board as a Non-Executive Director (NED) several months before I assumed the position of Executive Director in 1980. That makes him the only NED presently serving who has worked with all three chairmen and six Chief Executives, (formerly titled Managing Director) of this Company from its inauguration 60 years ago. He and I are the only two directors who had worked directly with our founder, Mr. T.H. Chan.

Born and bred in Hong Kong, Ronald was trained as a barrister in the United Kingdom. After practicing in Hong Kong for several years, he took on senior management responsibilities in companies before becoming a solicitor. He was a partner at one of the biggest local law firms. With his first-class brain, Ronald is a rare breed who adeptly blends legal expertise with commercial acumen. He is considered one of our city's wisest business minds. I am honored that he has agreed to serve for two years as my advisor in the Company.

Before closing, I want to take this opportunity to thank all our loyal staff who have carried out their duties professionally and faithfully during the pandemic. Our many frontline staff, in particular, are often exposed to danger. Last year, I singled out our colleagues in Wuhan for a vote of thanks; this year, I should mention our Hong Kong team. They are the unsung heroes who make the Company run smoothly. Our top management, together with the human resources team, have done our best to protect our staff from harm, and they in turn have rewarded all of us, including our owners cum shareholders, with their dedicated service. This is the Hang Lung spirit which makes all employees, myself included, proud to be working for this Company.

Ronnie C. Chan
Chair
Hong Kong, January 28, 2021

Addendum

On February 9, all the diplomatic obstacles to the Shouson Hill site acquisition, which we won in a tender last September, were satisfactorily resolved. Working with the seller, the transaction was consummated at noon today. This is a welcome development.

Ronnie C. Chan
Chair
Hong Kong, February 25, 2021