RESULTS AND DIVIDEND

For the six months ended June 30, 2022, revenue rose 7% to HK$5,302 million. Overall rental revenue remained stable at HK$4,986 million despite a resurgence of COVID-19 both on the Mainland and in Hong Kong. Net profit attributable to shareholders fell by 13% to HK$1,948 million. Earnings per share retreated similarly to HK$0.43.

Underlying net profit attributable to shareholders increased by 1% to HK$2,217 million when excluding property revaluation and all related effects. Underlying earnings per share stood at HK$0.49. We recorded a minor revaluation loss both on the Mainland and in Hong Kong. The year before, we had a slight gain.

The Board has declared an interim dividend of HK18 cents per share payable on September 29, 2022 to shareholders of record on September 15, 2022.

BUSINESS REVIEW

Since my last *Letter to Shareholders* of six months ago, it is truly amazing how much the world has changed. So has every major business almost anywhere in the world, and we are no exception. Recent global and domestic events have caused us to seriously review our strategy and our operations. I will write more in the next section under "Prospects".

Given the market conditions, I believe that we have turned in a rather respectable set of results. It may pleasantly surprise many.

In recent years, our two shopping centers in Shanghai — Plaza 66 and Grand Gateway 66 — accounted for slightly more than half of our Mainland rentals, or almost a third of total rental revenue for the Company when Hong Kong is taken into consideration. Due to the government policies of the past few months in response to the pandemic, those two malls were forced to completely close for about two months. Dine-in facilities were not allowed to operate for about three and a half months. Of the remaining eight facilities, four experienced shorter periods of lockdown. Everywhere, footfall fell. Rent relief measures like those of 2020 had to be reinstated in some cities.

Given this set of adverse externalities, it is quite encouraging that our total rental revenue on the Mainland, in RMB terms, managed to slightly exceed the same period a year ago. Retail rents collected were almost on par with those of last year's. The loss in revenue in Shanghai was more than made up by the gains from three areas: remarkable rental jumps in the malls in Heartland 66 in Wuhan and Olympia 66 in Dalian, as well as the continued strong performance of our Mainland office portfolio. All three of our new office towers, in Heartland 66 in Wuhan, Spring City 66 in Kunming, and Center 66 in Wuxi, saw significant increases in rents.

The message is clear. Whereas I expect our two Shanghai complexes to continue to perform strongly in the coming few years, our other luxury properties are growing at a much higher rate. They will account for an increasing percentage of our total revenue. This is especially true of our malls in Wuxi (Center 66), Dalian (Olympia 66), Kunming (Spring City 66), and Wuhan (Heartland 66).

Taking the Company as a whole, total revenue rose 7% to HK$5,302 million. Rental income was flat at HK$4,986 million. The difference between the two numbers came from the sale of a house at our Blue Pool Road project, the profit margin therefrom being 52%.

Overall rental margin slightly retreated to 72%. On the Mainland, it fell one point to 67%, and in Hong Kong, two points to 81%. Given the market conditions, these are to be expected and are due to minor bad debt provision. The same was experienced in 2020, of which some was subsequently recovered in 2021.

Over the six months being reviewed, six of our 10 Mainland shopping centers endured varying lengths of complete suspension. Even when shopping was allowed, dine-ins were often prevented. (In Jinan, where Parc 66 is located, authorities stopped dine-ins and operations of education related tenants, but did not shut down entire retail complexes.) Consequently, tenant sales could not but fall compared to the same period last year. Not counting Heartland 66 in Wuhan which opened in March 2021, on a like-for-like basis, total tenant sales at our remaining nine complexes fell 23%.

Fortunately, our other malls performed superbly, especially the newer luxury ones. Spring City 66 in Kunming and Center 66 in Wuxi both contributed nicely, in spite of the nine-day complete shutdown at the latter property. But as I had previously suggested to shareholders, the star performers would be Olympia 66 in Dalian and Heartland 66 in Wuhan. And they were.

Phase two at Olympia 66 in Dalian only opened little more than a year ago and is still filling up. Yet the arrival of top fashion brands in the past two years has completely transformed its character. Tenant sales shot up, followed gradually by rents. Rental reversions have been healthy. Over the next year or two, I anticipate not only a rise in occupancy, but also in average unit rent and rental margin.

Barely 15 months old, Heartland 66 in Wuhan has probably the fastest ramp up we have ever seen among all our malls. Tenant sales are already approaching that of Spring City 66 in Kunming, which is 19 months older. The property is being filled up and rental margin is rising nicely.

Rental margin is a particularly useful number to watch. For our mature luxury malls, like the two in Shanghai, it is at the high 80% and even low 90%. In tier-two cities, the same product type should be able to achieve mid-to-high 70%, if not low 80%. Center 66 in Wuxi is already approaching that range. Spring City 66 in Kunming and Heartland 66 in Wuhan should in time succeed. Olympia 66 in Dalian, being a much bigger facility, may one day achieve the lower end of that range. Frankly, there are few businesses that are as simple as ours yet enjoy these margins.

On the other hand, our sub-luxury malls should be able to make it to the high 50% and low 60% range. Parc 66 in Jinan is well on its way, although the present Asset Enhancement Initiative (AEI) will give it a brief pause. By way of comparison, our Hong Kong retail spaces, all being older properties, have an average rental margin in the low to mid 80%.

Another reason we did not see a drop in total rent on the Mainland was the stellar performance of our offices. It did well last year and the momentum so far sustained. Additional income from rent reversion, especially from shrinking vacancies, brought in RMB74 million more, which represented an increase of 16% from the year before. Six months ago, I explained how we could succeed in a highly competitive and oversupplied market. Here is another proof.

Conrad Shenyang is, so far, our only hotel that has opened on the Mainland. Under the throes of pandemic related restrictions, revenue could not have been exciting. But we play for the long haul. At Center 66 in Wuxi, we signed up the Hilton Group to manage our small boutique hotel under the Curio Collection brand. It is planned to have 106 keys and should open for business in late 2024.

In Hong Kong, the fifth wave of the pandemic caused havoc. For three and a half months out of the past six, restaurant hours were seriously curbed, and their relaxation only came gradually. We were fortunate to have kept overall tenant sales from falling compared to the same period last year. But comparing to the second half of 2021, the number was down by 15%. Retail rental revenue after rent relief amortization fell 3%. Occupancy held up at 98% while rental margin was slightly lower at 82%. Rental reversion was, however, more affected, which would render future rent levels lower.

Office revenues in Hong Kong also suffered. While occupancy held up, we took in 7% less and rental margin retreated four points to 83%. Average unit rent was down and rental revenue came under pressure. All these are a reflection of our city’s mode of dealing with the pandemic, which has cut us off economically from much of the world. Six months ago, I discussed this issue extensively and will not repeat it here. Not much has changed since that time.

PROSPECTS

We live in a globalized world of which our primary market, China, is an integral part. What happens in other parts of the world can quickly impact the Chinese economy, and so our business. This is why in the past decade or two, I have presented to shareholders, on this platform, Management’s view on global issues that may affect us. They range from geopolitics to geo-economics, and from technological developments to environmental issues. I have also attempted to make sense of Beijing’s domestic policies that concern us, even if only indirectly.

In the past few years, we have devoted considerable time to discussing the deterioration of China-U.S. relations. It has the potential of bifurcating the world, which would fundamentally change the way the global economy is organized and how business is conducted. As a company investing exclusively in China, we would not be spared. Not recognizing this, or misreading this ever-changing bilateral relations, may have grave consequences.

But, out of the blue, two new issues appeared that further complicate our analyses. Two and a half years ago, COVID-19 emerged and changed the world. Further surprises may yet surface. It is likely that the pandemic will, one day soon, become endemic. However, before we could fully digest all its ramifications, the Ukraine War erupted in February this year. This too will alter the face of the world.

Tragic and mostly immoral as wars are, human history is littered with them. In the present case, it is not the conflict itself that is changing the world, but the reactions of the West, a supposedly third party. The effects will be monumental and long-lasting. Since World War II (WWII), I can only think of very few events that are in that league. The reform and opening up of China in late 1978 was one, and the fall of the Berlin Wall in 1989 was another. Both happened with little fanfare, but not this time. The last two incidents, in some sense, united the world. This time, it divides the world. No major businesses are spared, ours included. We must rethink our future. Consider the following consequences of the war.

First, global capital flow will be disrupted and altered. When the U.S. can, at will, freeze U.S. dollar-denominated assets of countries and individuals, will the rest of the world still keep its wealth where this can happen? This by no means applies only to America's enemies or neutral parties. Her allies are also watching. The Trump administration shows the world that anything can happen in American domestic politics. Come 2024, Donald Trump or someone like him may occupy the White House. Will America's behavior around the world deteriorate further? Given the power the U.S. wields everywhere, none of us is immune. Everyone is watching with trepidation.

As a result, many will begin to take steps to shield their assets from the reach of Uncle Sam. Few will tell others about it, but once a collective momentum builds up, no one will be able to stem the tide. This may alter the existing global financial architecture. New York City and London may still be the biggest financial hubs, but a number of smaller centers may appear. Since WWII, major troubles elsewhere have caused capital to flow towards the U.S., or at least into U.S. dollars. This phenomenon may begin to change.

To meddle in SWIFT, the world's biggest transaction and payment platform, is to deploy a financial nuclear weapon. This time, the U.S. did the unthinkable. The U.S. can at will stop certain banks from conducting transactions through the system. Doubtless, this will cause many countries to gradually switch to parallel platforms, a few of which are already in existence. There will inevitably be a diffusion of financial transactions, which is a form of deglobalization. Inefficiencies will result, which will, at least for some time to come, increase costs.

Such weaponization of finance can combine to weaken the dominance of the U.S. dollar. No single currency will be able to replace the greenback, although the Euro and RMB are expected to gain popularity as transactional currencies. Witness the recent India coal purchase contract with Russia that was denominated in RMB.

Nevertheless, Beijing needs to control the circulation of RMB as a tool to regulate China's domestic economy. As a result, I do not foresee Beijing desiring to open her currency to capital accounts. Whatever the case, the weakening of the relative position of the U.S. dollar cannot be good for America. If this happens, Washington, D.C. has no one to blame but herself. Frankly, the greenback has been gradually losing ground, especially since the creation of the Euro some 20 years ago.

Another serious consequence of the Ukraine War, of the West's own making, is the spike in energy prices. Hurting Moscow by limiting her sales of natural gas to Western Europe ends up hurting herself as well. Where will Europe obtain in short order so much energy to replace Russia's supply? What will happen to countries like Germany when winter arrives? Her action begs the question: who is Europe sanctioning — Russia or herself?!

It is easier for the U.S. to insist on sanctioning Russian natural gas, as she is across the ocean and has plenty of resources domestically. Not so the case with Western Europe. In the heat of anger, some people on both sides of the Atlantic are not thinking, let alone thinking straight. Consider the U.S. having to go to her deadliest enemies like Venezuela and Iran to beg for an increase in energy production. This happened soon after reports that the leaders of traditional energy-rich friends like Saudi Arabia and the United Arab Emirates (UAE) declined a phone call from U.S. President Biden. When did such a thing ever happen? The world that we have known since WWII has indeed changed!

Since Peter the Great, Russia had wanted to be part of the West. The efforts lasted over three centuries, but this year, she was officially rejected. Russian President Putin even stated publicly that his country will now look east. By that, everyone understands it to mean primarily China, which eagerly needs Russia's energy resources, if not also its minerals and food.

Here is an interesting anecdote. Through a then Shanghai-based Russian shareholder of this Company, I was invited in 2015 to speak at one of the two sessions on Asia at the St. Petersburg International Economic Forum. The conference was supposedly attended by some 9,000 people, but only 27 showed up to listen to me and two other speakers, one of whom was Kevin Rudd, former Prime Minister of Australia. Now, I can safely assume that should the same event be held today, it would attract a much larger crowd!

Russia looking east today does not worry me that much. Unlike much of the 20^{th} century when she was a big brother to China, today the tables have turned. China has a much bigger and more advanced economy. Size-wise, it is almost nine times that of Russia. Economic complementarity and both sharing a common threat from the U.S. will keep the two historical enemies working together.

The one area of future concern may be Siberia. Russia looking east should mean the development of the vast land between the Ural Mountains and the Pacific Ocean. Sharing a 4,300-kilometer border with China must give Moscow some concern. The Russian side of that border is rich in natural resources but sparsely populated. On the other side, the reverse is true. How these dynamics are managed will be critical to both countries.

Just as Russia sells energy and food to China, so will she sell energy and minerals to India, a traditional friend and customer in the south. India also buys weapons from Moscow. These are basically simple business transactions. However, Russia's looking south towards the Middle East may prove to be problematic to the world. Being almost a single industry economy, that of oil and gas, Moscow may want to further influence energy-rich nations like Iran and Israel, as well as almost all the countries between them. Her further involvement in that region, which has always been a powder keg, may aggravate the situation.

As I have elsewhere written, I expect that Israel and her immediate neighbors will become major sources of natural gas to Europe. A deal was finally announced last month between Egypt, Israel, and the European Union (EU). This is the first time that the countries by the eastern Mediterranean Sea would become energy suppliers to Western Europe. It bypasses the circuitous routes and troubled territories that traditional suppliers like Saudi Arabia, Qatar, and the UAE have to endure.

It is difficult to expect Russia to do nothing while others take business away from her. The departure of the U.S. from the region may further embolden Moscow. America's traditional allies in the neighborhood are all preparing for that eventuality. One of the messiest regions in the world may become even more so.

The present war also brings short-term troubles that may turn into longer-term problems. I seriously doubt if Western capitals had carefully considered the possible consequences of their reactions to the War. Fuel price hikes, food shortages, as well as disruptions to the movement of essential minerals are reverberating around the globe. Famine will likely result in parts of Africa and beyond.

Both our natural and economic ecosystems are, in fact, quite fragile with little margin for error. Consider what would happen if a major natural or manmade disaster were to take place at this time, in almost anywhere in the world — an earthquake, tsunami, locusts, or a nuclear power plant incident, etc. Environmental degradation is already causing trouble everywhere, such as extreme weather, draught, flooding, forest fire, and more. The consequences of the war mentioned above will be greatly exacerbated, which may well push the global economy to the brink of collapse. I do not believe that this is too far-fetched a scenario to be taken lightly.

As is always the case, famine or fuel shortage, let alone economic collapse, will incite riots that can bring down governments. Historically, this is often how revolutions began. All these problems will also bring on mass migrations, as witnessed in 2015 from the Middle East to Europe. A likely movement this time may be from Africa across the Mediterranean into Europe.

Those of us living in East Asia or the Americas may be spared from human migration, but other effects of the Ukraine War would have ways to hurt us, and hurt they will. One is increased inflation.

Over the past few decades, most major economies have printed tremendous amounts of paper money. That in itself is inflationary. But what none of us could have known before the Ukraine War was its exacerbating effect on global price rise. The problem all too familiar to us in the 1970s and early 1980s cannot but return.

Almost no country can tolerate inflation. To counter it, the interest rate has to rise. Business will suffer but so will national governments if they have too much debt. The U.S. is a case in point. Interest payments alone will eat up much of the revenue. Yes, the U.S. Federal Reserve can always print more money but that game cannot continue indefinitely. Devaluation will sooner or later erode the world's confidence in the U.S. dollar.

Inflation is of particular concern to Europe. Many Western European countries rely heavily on Russia's natural gas. Either voluntarily or involuntarily, to not buy from Moscow is to cut one's own throat, for there are no easy alternative sources, at least insufficient for the near to medium term. Fuel shortage is already fanning the flames of inflation. This, in turn, will stir social discontent that would lead to political instability.

Frankly, many Europeans have entered into a state of collective hysteria. A highly intelligent banker friend of mine from Italy, as well as a very successful high-tech entrepreneur living in France, both see the recent Russia's behavior as an existential threat to their countries. I do not believe that Moscow has the intention or the ability to invade Italy or France. Nor is NATO, under U.S. leadership, a paper tiger. Yet, there is a real but irrational fear.

Once the Ukraine War settles, I believe that many of those Europeans will wake up and see their present reactions as unnecessary, if not outright foolish. Many of their actions today, of which some cannot be undone easily or reversed, will have long-term negative effects on themselves and the world. The damage is already done.

Who else are the losers of the present war, besides Ukraine and Europe? The poor countries, Russia, and the U.S. In other words, almost everyone! In the grand scheme of things, the first category has little impact on the world. While no one should underestimate the ability of Russia to withstand pain, for now, she is greatly weakened. Frankly, from an economic perspective, she too is not that significant in the world.

The opposite is true of the U.S. Consequently, America may be the greatest loser, for she has the most to lose. Consider the weakening of the dominance of the U.S. dollar. As mentioned earlier, it is not the war itself that is the most consequential, but the reactions of the West led by the U.S. The pain to be endured by the West is self-inflicted.

All of the troubles brought on by the Ukraine War listed above will fundamentally change global economics and politics. Their effects will be with us for decades to come. One way or another, China will be greatly affected, and so will our business. It would be irresponsible of Management if we do not carefully consider their consequences on our operations.

How will our primary market, China, be affected? The Ukraine War presents Beijing with immediate diplomatic challenges. Not wanting to antagonize either the U.S. or Russia, she has to tread very carefully. From what I can tell, so far so good. By not succumbing to the pressure from Washington, D.C. to condemn Moscow, China may, if called upon one day, serve as an honest broker for peace. If this materializes, then the West would have China to thank. But for now, I doubt if Washington, D.C. wants a quick resolution to the war.

In the longer run, China may, in fact, benefit. A weakened Russia will more than ever need the huge Chinese market for energy, food, and minerals. In 2014, when Moscow annexed Crimea, she also came under Western sanctions. Within a very short time, a natural gas transaction, long in negotiation but never consummated, was quickly signed between Beijing and Moscow. The latter needed the deal fast, and she is today in an even direr position.

As Management reconsiders our strategy and operations in the face of such monumental changes, we should not forget about the elephant in the room — the madness of the U.S. in beating up China. Many have rightly pointed out that Ukraine and Russia are a sideshow; the U.S. is really after China.

In this regard, the reactions of the West to the present war have unleashed forces that may force their governments to, for now, deal with more urgent problems rather than with China. For example, Washington, D.C. is constrained by domestic inflation to consider relaxing previously imposed trade tariffs on China. In the past few years, the U.S. had wanted to weaken China's role as the world's biggest supply chain center by building an alternative. That voice has fallen silent as domestic prices rose in America.

Because of the pandemic, some reshoring of the manufacturing of strategic products is inevitable. However, to completely rebuild a supply chain ecosystem is a totally different proposition. There is simply no other place on earth that can replicate what the Chinese had built over four decades in the Pearl River Delta and Yangtze River Delta. To accomplish that feat took a highly motivated and entrepreneurial people that numbered in the tens, if not hundreds, of millions. They must have a relatively high degree of education and skilled labor under supportive and wise government policies. The existing system was also a product of an era of unfettered globalization. It is efficient and offers the cheapest services to manufacturers in China and elsewhere in the world.

To concoct today a new structure that is strewn over many countries, languages, and cultures will not only introduce huge inefficiencies. It will also take decades to accomplish, if it could be accomplished at all, and to as good a quality as the existing one in China. Moreover, the cost will be prohibitive and hugely inflationary. Not even the West can afford it. Or, in today's already inflationary environment, perhaps especially the U.S. cannot afford it.

All this does not mean that China-U.S. relations will be smooth sailing going forward. The West's reactions to the Ukraine War remind us that no one should underestimate the foolishness of nations. Furthermore, Western democracy ensures that national interests in international affairs are often beholden to individual politicians. For selfish political reasons — and politicians are selfish — such as in the face of impending elections, the best interests of the country are all too often sacrificed.

Should we be worried about the Taiwan Strait? Yes, we should, and I worry much more about what American politicians would do than what Beijing might. As the U.S. midterm elections are approaching, the risks are particularly high. Even if we pass this year unscathed, next year the U.S. will begin to prepare for her 2024 presidential election. There is no end in sight. For China-U.S. relations, one can only hope that the effects of the Ukraine War will provide some distractions. But for global peace, that too is not a welcome development.

A final worry of mine outside China that should be mentioned is the domestic disharmony within the U.S. Her society probably has not been as divided as it is today since 1865 when the American Civil War ended. Social and political discord are spreading. Given the global leadership role that the country plays, such domestic problems cannot but affect the world. Consider the possibility of her retreating into isolationism, the tenet on which the country was founded. It will change the face of the globe.

Such is the external environment that we and any major business face today. Some issues predated the Ukraine War; others are the results of the war. All of them are serious.

Then there are concerns within China. The way the pandemic is being dealt with baffles the world. The recent Shanghai citywide lockdown tells it all. Its economic consequences are grave. Having written extensively on the subject before, I shall not belabor it here.

Over the past three decades, hordes of businessmen and professionals, young and old, poured into China in search of fortune. Most of them did not regret the effort, and frankly many fell in love with the country. Until recently, I have hardly heard of too many of them leaving because of social or political reasons. (Needless to say, there is some degree of self-selection. Those who are biased, or who otherwise do not like the domestic system, probably did not move to China in the first place.) Now for the first time, I learn of expatriates, some having lived there for decades, wanting to leave. At a time when Beijing is increasingly isolated by the West, this is not an encouraging sign.

The pandemic response is not the only factor hurting economic growth. Another major problem of late relates to residential developments and the cessation of mortgage payments in various projects. Many home builders are failing or have failed. If not handled properly, this economic trouble can metastasize.

For the past 16 years, I have served as a keynote speaker at one of China’s largest annual real estate forums held in Hainan Island. (Since 2020, including this year, I have attended online.) My message year after year was very consistent — that the residential development business as practiced was not sustainable. Somehow the conference organizer wants me to repeat it annually. Everyone nodded in agreement, but few have heeded my advice. They mentally accepted my arguments but could not emotionally oblige. I have written about it more than once in this Letter, warning that the bubble would one day burst.

As is often the case everywhere, when there is a real estate industry debacle, the banks are left holding the bag. Since the Chinese government owns most of the major banks, Beijing may have to one day foot the bill. It will further depress economic growth.

What I have repeatedly asked is: why did the government allow it to continue when the bubble is already very inflated? I understand that real estate is a strong driver of the economy, from land sales to financing, and from construction to interior decorations. It directly accounts for some 13% of GDP; when related industries are included, the number is more like 30%. Perhaps not wanting this musical chair game to end, Beijing let it continue. But as in the children's game, the music will sooner or later stop.

To be sure, this problem is not unmanageable by the government from a financial perspective. But the bigger the bubble, the direr and more long-lasting the consequences are on the economy. The music seems to have stopped and some developers will go bankrupt.

As I had previously explained in this Letter, unemployment in this industry should not be a serious problem. Projects can continue under new ownership, such as debt holding banks. Posing a more serious problem to the government is the displeasure of the home purchasers.

Hang Lung is fortunate not to be in the home building business on the Mainland. As such, the present mess does not directly hurt us. However, to the extent that it slows the economy, our business will be indirectly affected.

So, how shall Hang Lung management respond to the above international and domestic problems? We will be very cautious in the coming six to 12 months. We shall take all precautions to ensure financial safety. Any major capital outlay will be doubly scrutinized. There are simply too many uncertainties to warrant major investments, except in very rare occasions. The risk premium has greatly increased since the Ukraine War began. Let us buy ourselves time to observe China and the world and see how the situation will evolve. This is time for caution and not adventurism. Thankfully, we are financially sound, such that we should be able to withstand virtually any shock.

As to our longer-term future, I came to the following conclusion after much consideration. Given a five-to-ten-year horizon and probably beyond, China is and will still be one of the best places to invest. Relatively speaking, she promises social stability and a reasonable rate of economic growth.

Barring trouble in China-U.S. relations, especially over the Taiwan Strait, chances are good that China will remain relatively peaceful. The present leader is widely expected to remain in power for a third five-year term, a decision that the Party Congress will make later this year.

Looking at it purely from a domestic stability perspective, this should be helpful. After all, the greatest threat to the country is always domestic stability. Mr. Deng Xiaoping, the architect of the Reform and Opening Up Policy, was not ideological. His famous saying was: whether a cat is white or black, as long as it catches mice, it is a good cat. It was that pragmatism that brought tremendous prosperity to the country over the past 40-some years. Mr. Lee Kuan Yew directly or indirectly ran Singapore for over half a century. If he was limited to 10 years as Prime Minister, the island state would in no way be as prosperous as it is today. As long as Beijing leaders can keep the country relatively stable, her economy should continue to grow, and people's livelihoods, improve.

Having a centralized government structure, there is always the concern that Beijing would make serious policy blunders that she is unable or unwilling to correct. It is not sufficient to have the right policy; the means by which it is executed must also be wise. There is a saying that the disease may not kill the patient but the medicine will. In China, all major decisions are made at the top. Policies are formulated there as well as the plans to execute them. This means that those at the top and their advisors must have a very broad knowledge of things. It is not easy.

I recall an incident several years ago when top government officials began to interfere in the stock market. A common investor would know that such a thing should not be attempted — it could hardly achieve the stated goal and might bring undesirable consequences. But those top Beijing decision makers had probably never bought stocks before and so were ignorant. They did not have an intuitive feel — and hence the necessary respect — for the market. Fortunately, someone must have warned them of the impending dangers and they quickly reversed the mistake.

This illustrates the challenges inherent in the Chinese system. So far so good, but the way forward is fraught with danger. After all, the world is getting more complicated by the day. Technology is one cause; the ever-changing international relations in an interconnected world is another. We can only wish the country well.

As I have stated before, the Chinese system is like a person with a heart condition, while the Western system is like a patient with cancer. Both can kill, albeit in different ways. The former can live her whole life in peace, but a heart attack can arrive anytime unannounced. Someone suffering from cancer will likely die from it one day, but it may not be imminent. It can drag on for some time.

Back in Hong Kong, our economy is also facing challenges. What was spared from the 2019 social unrest was weakened by the way we had to confront the public health threat. The aftermath of riots led many locals to emigrate, and the partial lockdown of the past two and a half years due to the pandemic compelled many expatriates to leave. Nevertheless, both can later be partially remedied. For example, we can attract qualified people from the Mainland to move here. In fact, for their own reasons, some Mainlanders with capital and higher education are already quietly relocating here. That notwithstanding, the immediate economic future of this city is challenging.

For now, the Hong Kong mass residential market is weak. It is a combination of a weakened economy and out-migration. It may recover one day but the longer-term prospect of this sector remains uninteresting to us. We have not played in it for decades and I see no reason to return. After all, with the settling down of social turmoil, land supply will sooner or later increase considerably. That will become a cap to prices.

The luxury housing market in which we play is a different story. The last time I saw so many wealthy Mainlanders arrive in Hong Kong was probably in the early 1950s due to political changes up north. This time the reasons are different. Hong Kong still holds much charm to our compatriots — lower taxes, a freer society, better informational connections with the rest of the world, more choices of schooling for the children, etc. The recent Shanghai lockdown has only strengthened the resolve of the well-to-do. To be sure, they are a small percentage of the financial elites on the Mainland, but Hong Kong is a very small place compared to the rest of the country. Even smaller is our luxury housing sector.

There is no perfect place to invest; every economy has its unique risks. Mainland China has had a good run of 40-some years since her economic opening, although there was a near miss in 1989. The only way that a business can survive in the long term is to be always financially prudent. This way, it can ride out the periodic rough patches that are inevitable. That inevitability is again with us today.

As a company investing exclusively in China (including the Hong Kong SAR), frankly, we do not have many alternatives. To be financially prudent in our industry does not just mean to be lowly geared as we always are. It also means that we do not make major mistakes in capital investment decisions. So far, we have done well since we entered the Mainland market 30 years ago. But in light of the deteriorating global scene and China's challenging economic conditions, we should be particularly careful in the coming year. Management will take all necessary measures to cushion ourselves from whatever may come our way.

In my 32 years of writing this mid-year Letter, this time may be the most difficult to forecast full-year results. The reason is that no one can tell how the pandemic will evolve, nor how the government will respond to it. A big question is: will the Shanghai lockdown repeat itself? Will any of the other cities in which we have a presence undergo a complete or partial lockdown?

A reasonable assumption for the rest of the year is that the pandemic will still be with us, but that the government will not totally lock down a city. The Shanghai experience must have been painful to all, including Beijing leaders. They should be able to do a better job next time. Even so, it is unlikely that normalcy will fully return soon. All these will inevitably affect our performance.

In cities where some semblance of normalcy returns, I anticipate encouraging results. This certainly includes Shanghai. In fact, there may be a strong rebound in sales.

The momentum in Olympia 66 in Dalian and Heartland 66 in Wuhan should be able to continue. Their recent outperformance is not primarily a consequence of favorable external market forces; it can be directly ascribed to Management's efforts. Olympia 66 has been transformed into a truly luxury mall. Many top fashion brands have just opened in the past year, and phase two is filling up. A similar story is true for Heartland 66 which is 16 months old. It has even more illustrious fashion brands as tenants. Located in a much bigger and more affluent city, its potential should be even greater.

I expect Center 66 in Wuxi and Spring City 66 in Kunming to, again, trade well. The amount of wealth in the former city is truly impressive, and I do not believe that we have fully exploited it. More good news may follow.

In the foreseeable future, our two Shanghai properties should still be the landmarks of our portfolio. I anticipate healthy growth for some time to come. That said, their dominance will lessen as our other luxury properties mature. That is a welcome development.

The sub-luxury malls will do fine but not spectacularly. This is the nature of the beast, although Management must admit that there is much room for improvement. Parc 66 in Jinan is being upgraded and should bring reasonably pleasing, if not extraordinary, results in the coming year or two.

After some two years of outperformance, growth in our Mainland offices may slow down a bit. That said, these properties are now contributing significantly to our top and bottom lines. Taken as a group, they collect more rents than any of our individual malls except the two in Shanghai. They provide very steady income.

Like on the Mainland, our Hong Kong rental business for the rest of the year will depend on how the pandemic evolves and what policies the local government adopts. For now, it may be safe to assume that the second half will be similar to the first. Even though dine-in restrictions have gradually been relaxed since mid-April, the fifth wave of the pandemic is still with us. As such, rents will still be under pressure, and our total Hong Kong rental revenue may not have bottomed. That said, I do not foresee a serious deterioration. In fact, there is always the possibility that business will slowly pick up from here.

As previously described, for different reasons, the residential markets both in Hong Kong and the Mainland are, for now, weak. It will affect our original plan to sell. Since this is not our primary business, I do not see this lull to be of much significance. Given the nature of real estate where there is hardly any product obsolescence, the only effect will likely be the timing we book profit.

Ronnie C. Chan
Chair
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