Vice Chair's Notes

Adriel Chan
Vice Chair

Warmest wishes for the New Year, and thank you for your continued support of Hang Lung.

I write again from various cities in mainland China, which are humming along very smoothly, all things considered. As people travel to and from their home towns for the long Chinese New Year holiday, based on the Chinese government's previous approach, the inevitable sporadic COVID flare-ups should be quickly identified and contained, which means that malls, restaurants, cafes, and bars should basically return to their normal, buzzing selves soon after. The atmosphere is upbeat, and I am confident that we are seeing the start of a solid 2022, provided COVID throws us no curveballs.

Since international travel to China continues to be difficult, I will share a few observations made on my travels across China so far this year, which may not be evident from abroad. I hope you will find them as useful and actionable as I have.

Speed, Intensity, and Effectiveness of COVID Clampdowns, and their Effects on the Market

There is still no getting away from COVID. Though there has been talk of the Omicron variant being the beginning of the end of the pandemic, it is premature for us to expect this imminently. The Chinese Government has acknowledged the need to react and adapt their strategy to changing conditions, which is positive, and we look forward to any measures which will further improve the operating environment. However, this pandemic has been unpredictable in character, and so we can only wait and see. We are, of course, taking all the precautions that we can.

Meanwhile, the current approach appears, still, to work, though the high transmissibility of Omicron has made it even more challenging. Mainland China uses very targeted, very strict contact-tracing, testing, and lockdowns. This helps ensure that the vast majority of people are minimally affected, and thus businesses can generally stay open. Naturally, this is good for our retail business, and so, to some extent, we have it to thank for our satisfactory results. Those who look at our results more closely will note that the second half of 2021 did not grow as quickly as the first; this is in part due to several of these targeted lockdowns in the cities in which we operate, as well as two extreme weather events which affected our Shanghai and Wuxi malls for several days each.

On the whole, however, despite the broader disruption it has brought, COVID has been an unexpected boon for our core business, and I expect the growth to continue at a very healthy but moderated pace. Observers rightly point out that the pandemic has already "onshored" virtually 100% of Chinese luxury sales. Prior to COVID, however, only about 30% of Chinese luxury purchases were made domestically, with 70% made in Hong Kong, London, Paris, and other international marketplaces. However, I believe that this "onshoring" was only one of three main drivers for Hang Lung's performance.

The full thrust from the two other drivers should be seen this year. First is the incremental luxury consumption of the Chinese customer. Through the course of the pandemic, the total value of Chinese luxury spending (i.e. domestic + international) has shrunk by about 30%, from over 90 billion Euros in 2019 down to around 60 billion Euros in 2021*. With the return to pre-pandemic travel looking just as unlikely now as it did this time last year, I expect overall Chinese luxury sales to slowly catch up to their previous levels. The vast majority of this will continue be done domestically, and much of it in our malls.

* Source: *A Year of Contrasts for China's Growing Personal Luxury Market.* 2021, Bain & Company, P.8.

The second driver is the increasing share of the Chinese luxury pie that Hang Lung is capturing. The long winter that we experienced from 2011-2017 was not wasted. Under the wise guidance of our previous CEO, Mr. Philip Chen, management laid the foundations (six new malls) and developed the tools (systems and management) to capture the luxury market when spring would return. Thus, when spring finally came in 2018, we sprung our trap. In the four years since, we signed over 100 top luxury brand contracts, and five more of our malls have taken leadership in their respective luxury markets, with work ongoing on a sixth.

For the above reasons, I remain confident that we will continue on a very healthy trajectory for some time to come.

Knock-on Effects from "Common Prosperity" and Regulation of Educational Institutions

Observing the government and markets since the initial turbulence that surrounded the "common prosperity" announcement, I have come to believe that the intended outcome is to create *more* buyers of luxury brands, not fewer. Thus, this should be beneficial to us, rather than detrimental. It appears that both brands and management consultants agree with this view. Supporting this, January figures are still strong, and our tenants continue to break their own sales records.

The shift in focus of children's activities from rote academics to more arts and sports is also beneficial to our facilities. Specialty sports centers and arts and crafts trades are increasingly entering our malls, which drive foot traffic and increase customer dwell time. They are well-suited to awkward or otherwise difficult-to-lease spaces, and have the added benefit of engaging children, which frees their parents and grandparents to browse the malls. This shift in government policy means parents will spend more time with their children, since children now spend less time in study groups. As a matter of course, we are working to capture more of this time in our facilities. Diversified academic studies should lead to broader interests among future consumers, which will drive more demand for niche trades in our malls (e.g. outdoor activity brands). In the same vein, I expect a further diversification of styles and fashion preferences, which is also beneficial to our operations.

Since our Chair has elaborated on the "Evergrande Phenomenon" in his letter to shareholders, I will not discuss it here.

The Rise of Domestic Chinese Brands, and the Plateau of Some International Brands

Browsing our malls in mainland China, you will generally find at least one floor of apparel brands that you have never seen nor heard of in North America or Europe. (In many cases, you will also have a hard time pronouncing their names.) The branding, displays, merchandising, and service are at least on par with what you would find at a high-end European department store or designer label. More importantly, the products are of very high quality, and the styles are even closer to the trends. These are the local brands and designers that are climbing up the price ladder and putting pressure on their international peers. The surge of national pride resulting from the Winter Olympics (as well as other unnecessary geopolitical causes) has added fresh fuel to this flame, which had otherwise been burning quite slowly over the past decade or two.

This pattern is probably most obvious in the sports category, where domestic brands are now steadily taking share from their European and American counterparts. I can personally vouch for the quality of the design and construction of domestic sportwear, which are now on-par with (if not better than) the biggest international names. What I find most impressive is that I could not have said this before the pandemic; that is to say, they are improving with incredible speed. As they do better business, we will also be a beneficiary.

These observations give me reassurance that not only have we chosen an excellent strategy, but that we have also done as much as we can to capture the huge opportunities that they open-up. I hope you will agree.

I will wrap up with a quick comment on Hang Lung's sustainability journey.

In the past year, we have made remarkable progress. While sustainability is, importantly, one of our core corporate values, it is also one of my own. I am especially proud of what *all* of my colleagues, leveraging our small Sustainability Team, have achieved in such a short time. The intentionally small Sustainability Team means that the understanding, planning, and implementation of our strategy must be pushed deep into Management, which gives us better understanding and buy-in, and thus higher quality execution.

These achievements are concisely captured in our **25 x 25 Sustainability Targets** ("25 x 25"). Hang Lung's 25 x 25 give us clear short- and medium-term milestones through 2025, helping to bridge the gap to our 2030 goals, which are among the most ambitious in the real estate industry. I hope that you will appreciate our effort when you see the details in our 10th stand-alone *Sustainability Report*, which will be released in a few months.

Finally, I must take the time again to thank all of my colleagues for the resilience, flexibility, and dedication that they have shown over another challenging year. Thank you.

Adriel Chan
Vice Chair
Shanghai, January 27, 2022