Six months ago, I wrote my inaugural *Vice Chair's Notes* from Shanghai. After four months there, I have returned to Hong Kong, where I write this interim note. The information garnered from that trip, where I visited 20 cities (including Wuhan —— four times), has been both valuable and surprising. At the end of this note, I will highlight a few of our sustainability initiatives, which we have spent much time and energy crystalizing and refining, in order to align with our 2030 goals and targets announced last December.

In short, it is gratifying to see that the observations that I made earlier this year have come through in our very healthy interim results. Without exception, tenant sales, foot traffic, and rentals are up across our Mainland portfolio, and not insignificantly. Here in Hong Kong, we continue to suffer from the drag-on effects of the COVID-19 pandemic and closed borders, but it looks like we have reached the trough.

Year-on-year, our overall Mainland property leasing business grew by 33% in RMB terms, within which mall rentals grew by 38%, and offices by 12%. Notably, our luxury mall rentals grew by a staggering 46%, while sub-luxury malls grew by a modest 3%. This shows a two-tiered recovery, clearly driven by high-end consumption. I will return to this later.

In this note, I hope to add some color to our financials: how our stakeholders and consumers feel, the attitude on the street, and how Hang Lung is responding.

On my travels, I gauged the economy and sentiment in various non-scientific ways. In addition to what you might expect, i.e., the standard itinerary of visiting retail malls and outlets, meeting customers, tenants, local governments, contractors, consultants, etc., I have endeavored collection of less formal data. This comes partially from my strong network of on-the-ground friends and acquaintances —— built over dozens of years visiting mainland China, and six years living in Shanghai —— who give me genuine, unbiased feedback, and partially from my unique approach to getting to know cities.

Firstly, our mid-term results show very clearly that mainland China has been experiencing a super-strong recovery; this much is obvious when you walk through our malls (or, in fact, any main street on the Mainland.) Speaking with anyone living in mainland China, there is an immense sense of optimism, dynamism, and progress. This is difficult to quantify, but the excitement is palpable, and I have cross-checked this with multiple sources, from regional consumer brand heads, to investors, to China observers; everyone senses the same intense buzz. If we accept that the sentiment and sales performance are reliable indicators, the natural follow-up questions are: what is driving such robust consumption, and is it sustainable?

There are many reasons for the especially strong luxury consumption, but I will only focus on three:

1) Primarily, as a result of the global pandemic, international travel has all but stopped. If you trust the Bain & Company's report on mainland China's luxury consumption, which came out several years before the pandemic, the mainland Chinese had been spending something like two times as much on luxury goods outside of mainland China as they had within. That is, for every RMB100 spent on Louis Vuitton on the Mainland, they were spending around RMB200 outside. Mathematically, this tracks surprisingly closely to our observed first half tenant sales increase of over 122% in our luxury malls. Of course, our tenant sales also include those of other trades like entertainment and F&B, not just luxury, which is why our figure was less than 200%.

2) In addition to the inability to travel, there is, of course, the continuing structural growth of the Chinese middle class, which brings with it a desire for better living standards, including luxury products. I expect this trend to continue for the foreseeable future, which you might tie very roughly with the country's GDP growth. If you believe in China's ability to execute her latest five-year-plan, then it should be safe to assume that this growth will continue for at least the next five years. On top of this, we also expect to benefit from the increased focus on internal high-quality consumption, and urbanization.

3) Another unique driver for luxury consumption in mainland China is the lack of domestic investment options. (Similarly, this partly explains the Chinese love for investing in property.) Unlike in developed countries that have deep and sophisticated investment markets which include stocks, bonds, derivatives, foreign currency, real estate, wine, art, and everything in-between, a wealthy Chinese individual has a comparatively limited set of investment options. There is a large but relatively unsophisticated stock market, a recently opened bond market (with few good options), many questionable "wealth management products", and not much else. This explains why the Chinese real estate sector is as popular as it is, but also explains the P2P (peer to peer) lending craze several years back. As affluent Chinese continue to look for investment opportunities, the art and fine wine markets have understandably made leaps and bounds over recent years. It is no wonder, then, that wealthy Chinese should also spend freely on luxury goods. After all, do not LVMH, Kering, Richemont, Chanel, and Hermès seem to be constantly raising prices? Why not invest in a Birkin or a Rolex, since it is all but guaranteed to appreciate, and can be enjoyed immediately?

With these three reasons for sales volumes in mind, the question turns to whether or not it is sustainable.

Given the current state of the world, the most immediate question surrounds point 1), that is, the repatriation of luxury consumption to mainland China as a result of the pandemic. Will the Chinese flock back to Paris, Milan, London, Tokyo, or Hong Kong once travel restrictions have eased, thus re-expatriating all the retail growth that we have seen in the past year or so?

For several reasons, I am confident that we will not see a mass exodus when travel returns. Firstly, and quite unfortunately, it seems that this state of pandemic uncertainty will linger for quite a while longer. Optimists point at 2022, while I have heard more conservative experts talking about 2024 or even 2025 for a return to normal. That said, even when "normal" does return, it will almost certainly not come overnight. Secondly, by the time we reach that point, Chinese luxury consumers will have built up both the habit and the relationships that are so crucial in luxury spending. They will no longer want to line up in the rain on the Champs-Elysees, and then not be able to buy the bag that they want because they do not have the purchase history with that store nor the relationship with a sales associate. However, due to the pandemic, within mainland China, the same customer will have built up the purchase history as well as the relationships, which will allow them access to the most coveted bags, not to mention much better service. On top of these, Hang Lung is also building strong relationships with customers, which we hope will make them even more loyal to us.

Points 2) and 3) are relatively more structural, or at least further out of our zone of influence, so I will not expand on them here, though I would love to discuss these with you at our next AGM or on an investor call.

Coming back to my earlier point on a two-tiered recovery, there are two observations that give me pause. First is that our recovery is clearly driven by our luxury malls, and so there is a question about the type of returns that we should expect from our sub-luxury malls. Second, and perhaps more disconcerting, is that there appear to be lingering regional hangovers from the pandemic. On my travels, I asked my friends and colleagues about the status of *their* friends' and family's income and employment, and only in the Northeast were there colleagues whose friends or family were asked to take no-pay leave, to take pay cuts, or to leave their companies. Especially since the world, including mainland China, is now facing the rapid spread of the Delta and other variants, this is something to keep an eye on.

The point about luxury outperforming sub-luxury is also worth exploring. There are several explanations for this. I believe that the main reason is the uneven impact of the pandemic on different strata of society. The pandemic has shown, across the world, that the under-privileged/poor suffer disproportionately more than the wealthy. Malls that cater to a more mass market will naturally reflect this.

Secondly, the relative underperformance of our sub-luxury malls reflects the acceleration of a trend that was already far along in China, that is, the shift to e-commerce for goods that are most suited to it. This has meant that mass-market malls which sell lower priced discretionary products have been impacted more than luxury malls. I interpret the fact that we have still seen growth in our sub-luxury malls as a continued consolidation of the market into our best-in-market offerings.

I would also like to take this opportunity to highlight the solid progress Hang Lung has made in our sustainability endeavors over the past six months. Working toward the 2030 sustainability goals and targets that we announced last year, we have started and completed various programs covering all ESG aspects. Some highlights include identifying specific KPIs for each department to achieve this year (under "governance"), an annual greenhouse gas (GHG) mitigation plan for our scope 1 and scope 2 GHG emissions (under "environment"), and our first ever employee engagement survey, which managed to capture feedback from over 97% of our staff across both Hong Kong and mainland China (under "social").

To help us achieve our ambitious sustainability goals, we have expanded the sustainability team this year. However, rather than continuously growing the team into a blunt instrument, my goal is to use the purposefully small team as a lever, working with every department to ensure that the entire company is angled toward sustainability, embedding the necessary metrics and culture to achieve sustainability leadership.

Despite the uncertain backdrop of the COVID-19 pandemic, China-U.S. relations, and climate change, I feel very good about both Hang Lung's business as well as the direction in which the market is heading. We occupy a very unique —— but also unparalleled —— space in mainland China's high-end retail sector which has already begun to blossom, and I look forward to reaping the rewards in the coming years.

The velocity of change over the past year has been immense, but our strong and experienced team has managed to help us deliver an outstanding set of results. For this, I must give my colleagues every credit —— and my sincere thanks —— for helping us navigate these uncharted waters.

Adriel Chan
Vice Chair
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