# Forward

We adopt prudent and comprehensive financial management strategies to maintain a strong financial position with a high degree of moving forward to meet the Company's capital commitments and long-term business plans.

Forum 66, Shenyang


Grand Plaza

Olympia 66, Dalian

# Financial Review

## Consolidated Results

Total revenue of Hang Lung Group Limited (the Company) and its subsidiaries (the Group) decreased 15% to HK$10,015 million for the financial year ended December 31, 2018, as a result of fewer residential units sold during the year. Revenue from property leasing advanced 5% to HK$8,784 million. Property sales revenue decreased 64% to HK$1,231 million. Total operating profit declined 13% to HK$7,249 million.

Underlying net profit attributable to shareholders decreased 21% to HK$2,631 million. Net profit attributable to shareholders dropped 1% to HK$5,285 million after including a revaluation gain on properties. Earnings per share decreased to HK$3.88.

### *Revenue and Operating Profit*

| | Revenue | | | Operating Profit | | |
|---|---|---|---|---|---|---|
| | **2018 HK$ Million** | 2017 HK$ Million | Change | **2018 HK$ Million** | 2017 HK$ Million | Change |
| **Property Leasing** | **8,784** | 8,354 | 5% | **6,484** | 6,074 | 7% |
| Mainland China | **4,686** | 4,372 | 7% | **3,034** | 2,734 | 11% |
| Hong Kong | **4,098** | 3,982 | 3% | **3,450** | 3,340 | 3% |
| **Property Sales** | **1,231** | 3,420 | -64% | **765** | 2,238 | -66% |
| **Total** | **10,015** | 11,774 | -15% | **7,249** | 8,312 | -13% |

## Dividend

The Board of Directors has recommended a final dividend of HK61 cents per share for 2018 (2017: HK61 cents) to be paid by cash on May 21, 2019, to shareholders whose names appeared on the register of members on May 7, 2019. Together with an interim dividend of HK19 cents per share (2017: HK19 cents), the full year dividends for 2018 amounted to HK80 cents per share (2017: HK80 cents).

## Property Leasing

Against the backdrop of the Sino-US trade war (Trade War) and other global uncertainties, our property leasing performance showed resilience to achieve decent growth in both income and profit. Total property leasing revenue grew 5% to HK$8,784 million. The Hong Kong leasing portfolio generated 3% more in revenue while income from the Mainland properties increased 7%.

Gross domestic product (GDP) growth in Hong Kong for the first three quarters of 2018 was 3.7%. After five consecutive months of double-digit increases since February 2018, the retail market has slowed down to grow at 1.4% year-on-year in November 2018. This index was significantly influenced by high-value items. As our properties in Hong Kong are not luxury-driven, we have experienced a steadier growth in sales and rental revenue throughout the year.

GDP growth in mainland China for 2018 was 6.6%. Although the Trade War has caused jitters at the top end of the market, the luxury sector has been resilient on the strength of the "bigger" brands, showing healthy growth since the second half of 2017. This growth was supported by several factors such as the RMB depreciation, which led to more domestic spending, the tightened border controls on undeclared imports, and the e-commerce law to combat parallel import "daigou" activity.

## Mainland China

The performance of our mainland China leasing portfolio was encouraging in 2018. Revenue climbed 4% to RMB3,950 million, or 7% when excluding certain areas temporarily closed for renovation at the mall of Shanghai Grand Gateway 66. A strong growth momentum was being built up during the year. Revenue of the Mainland properties in RMB terms achieved growth rates at 6% and 2% during the second half and first half of 2018, respectively, compared to a year ago. In particular, revenue of Mainland properties outside Shanghai advanced 7% year-on-year, with a 9% growth in the second half year. Operating profit grew 8% to RMB2,554 million. Average margin recorded growth of two points to 65%.

Our eight malls in mainland China reported revenue growth of 3% to RMB2,755 million, or 6% when excluding the renovation impact of Grand Gateway 66. The asset enhancement program at Shanghai Plaza 66, which has been completed in phases since January 2017, not only added value to the asset but also potential for future rental revenue growth, thus contributing to strong revenue and retail sales growth in 2018. The revenue growth in Plaza 66 more than compensated for the short-term income disruption caused by the upgrading work at Grand Gateway 66. Outside of Shanghai, all properties, except Forum 66 in Shenyang and Riverside 66 in Tianjin, made good progress in leasing revenue.

Our office portfolio in mainland China generated 8% more in revenue to RMB1,058 million. The Plaza 66 office towers recorded income growth against keen competition as a result of our rigorous effort to retain quality tenants and solicit new ones at above average market rents. The office towers at Grand Gateway 66, Forum 66 and Center 66 continued to grow in both revenue and average occupancy rate. Income from all the office towers accounted for 27% of our total mainland China leasing revenue.

### *Mainland China Property Leasing Portfolio*

| | Revenue | | | Occupancy Rate* | |
|---|---|---|---|---|---|
| **City and Name of Property** | **2018 RMB Million** | 2017 RMB Million | Change | Mall | Office |
| Shanghai Plaza 66 | **1,554** | 1,409 | 10% | 99% | 95% |
| Shanghai Grand Gateway 66 | **1,176** | 1,241 | -5%# | 79%# | 94% |
| Shenyang Palace 66 | **162** | 155 | 5% | 88% | N/A |
| Shenyang Forum 66 | **216** | 213 | 1% | 93% | 88% |
| Jinan Parc 66 | **292** | 271 | 8% | 96% | N/A |
| Wuxi Center 66 | **252** | 219 | 15% | 89% | 86% |
| Tianjin Riverside 66 | **179** | 181 | -1% | 90% | N/A |
| Dalian Olympia 66 | **119** | 99 | 20% | 79% | N/A |
| **Total** | **3,950** | 3,788 | 4% | | |
| Total in HK$ Million equivalent | **4,686** | 4,372 | 7% | | |

# About 19% of leasable area was temporarily void for major asset upgrading.

* All occupancy rates stated therein were as of December 31, 2018.

### *Shanghai Plaza 66*

A strong performance was achieved for both the mall and office towers of Plaza 66, which reported a total revenue growth of 10% to RMB1,554 million.

The Plaza 66 mall earned 12% more in revenue during the year. After completion of the asset enhancement program in 2017, the mall successfully anchored its leading market position as the Home to Luxury, capturing the upswing in luxury sales and then converting it into strong growth in both revenue and retail sales. In September 2018, a brand-new customer relationship management program, HOUSE 66, was launched at Plaza 66. HOUSE 66 is dedicated to providing customers with unique and personalized services, allowing us to establish a more personal and enduring relationship with our loyal customers. Retail sales at the mall rose 13% year-on-year as a result, with occupancy rate increasing three points to 99%.

Income of the two office towers at Plaza 66 rose 7% to RMB622 million as a result of new lettings and expansion by existing tenants. The enhancement works for Office Tower Two were completed during the year, thus boosting overall occupancy rate by six points to 95%.

### *Shanghai Grand Gateway 66*

Affected by the three-year asset upgrading program commenced in 2017, Grand Gateway 66 reported a total revenue drop of 5% to RMB1,176 million in 2018. Nonetheless, when excluding the impact of the rental disruption caused by the upgrading program, total revenue was up 1%.

Income of the Grand Gateway 66 mall retreated 9% to RMB803 million, but was flat when excluding the renovation impact. The first phase of the upgrade works covering the entire North Building was finished and the face-lifted building re-opened in September 2018. The renovated area has a good mix of fashion & accessories, food & beverage, and lifestyle & entertainment tenants of more than 80 brands, of which 18 were making their first appearance in Shanghai or indeed in the Mainland. The renovated cinema with about 1,500 seats in 11 houses was re-opened, equipped with the world's leading visual and audio technologies to offer audiences a superior experience. The next phase of the upgrade program commenced in July 2018, covering the bulk of the South Building including the transformation of the mall's main entrance and its basement and the building of a linkage with Metro Link 9. These works are expected to be completed in stages starting in late 2019.

During the renovation, innovative promotional campaigns and customer experience activities were launched while many exclusive pop-up stores were introduced in order to maintain the mall's vibrant ambience and the business continuity for key tenants. Retail sales decreased 3% year-on-year on a comparable basis when excluding the impact of renovation.

Income of the office tower at Grand Gateway 66 climbed 6% mainly attributable to higher occupancy, which increased four points to 94%. The majority of upgrading works of the office tower was completed during the year.

Revenue of residential and serviced apartments at Grand Gateway 66 grew 1%. Occupancy rate rose four points to 90% despite the disruption caused by the mall's enhancement works and the nearby construction sites.

### *Shenyang Palace 66*

The Palace 66 mall achieved steady growth in revenue of 5% to RMB162 million. Occupancy rate was 88% at the end of 2018. Retail sales increased 7%. During the year, more sporting and popular lifestyle fashion brands were recruited, with many trend-setting, emerging and lifestyle brands making their first appearance in the mall.

### *Shenyang Forum 66*

Total income of Forum 66 increased 1% to RMB216 million as a result of the strong revenue growth from the office tower, which was partly offset by the drop in revenue from the mall.

Income of the office tower at Forum 66 grew 15% to RMB117 million, with occupancy rate increasing eight points to 88%. The six floors in the high zone of the tower, representing 14% of leasable area, were available for leasing from July 2018. The top 19 floors of the office tower are being converted into a Conrad hotel, which is scheduled for opening in the second half of 2019. The Conrad hotel is destined to become a focal point for business and social gatherings in Shenyang.

Revenue from the mall dropped 11% as we were in the process of optimising the tenancy profile. Retail sales at the mall slipped 1%. To meet the needs of the local market, more lifestyle and family-related elements were introduced during the year. As a result, occupancy rate jumped 10 points to 93%.

### *Jinan Parc 66*

The Parc 66 mall reported a healthy growth in the year. Revenue advanced 8% to RMB292 million, with occupancy rising two points to 96%. Retail sales jumped 18%. During the year, the mall's trade mix was further enhanced with several first-in-town brands brought in, more non-conventional shopping, entertainment and lifestyle elements introduced, and food & beverage brands upgraded. Following the successful debut in Shanghai Plaza 66, HOUSE 66, our new customer relationship management program, was launched in Parc 66 in December 2018.

### *Wuxi Center 66*

Center 66 performed remarkably well during the year with a revenue increase of 15% to RMB252 million, despite 9% of the mall's leasable area being temporarily closed for the construction of the second office tower.

Driven by positive rental reversions and higher occupancy, the mall's income jumped 19% with retail sales increasing 20%. Occupancy advanced two points to 89%. The 9% of the mall closed because of construction of the second office tower will re-open in the middle of 2019. That area will become the podium of the second office tower and house a new cinema as well as more luxury brands and quality food & beverage tenants.

Revenue of the office tower increased 8% to RMB83 million attributable to an increase in average occupancy over the year. Warmly received by multinational and national corporations including renowned financial institutions, this tower out-performed other Grade A offices in Wuxi in both occupancy and effective rent. Leasing activities for the second tower have commenced with good progress being made. The tower will be ready for handover to tenants in the second half of 2019.

### *Tianjin Riverside 66*

Income of the Riverside 66 mall slipped 1% to RMB179 million as the mall has been undergoing a tenant mix refinement after completion of the first lease term introduced at its opening in 2014. At the end of 2018, occupancy rate improved one point to 90%. More lifestyle and entertainment tenants, including a new cinema with 570 seats, were introduced during the year to offer a more comprehensive experience to customers. Owing to more competition from new malls opened in the city during the year, retail sales declined 8%.

### *Dalian Olympia 66*

In 2018, the Olympia 66 mall recorded double-digit rental growth for the second consecutive year. Income jumped 20% to RMB119 million as good progress was made in building up occupancy and increasing footfall. Occupancy increased eight points to 79%. Retail sales surged 36% driven by the business growth of trendy lifestyle and food & beverage tenants.

## Hong Kong

Total revenue and operating profit of our Hong Kong leasing portfolio both achieved a mild growth of 3% to HK$4,098 million and HK$3,450 million, respectively, in spite of the high base. Overall rental margin was 84%. With our efforts over recent years in asset enhancement and improvements in tenancy profile, we have laid a solid foundation for sustainable growth in future years.

### Hong Kong Property Leasing Portfolio

| | Revenue | | | Occupancy Rate* |
|---|---|---|---|---|
| | **2018 HK$ Million** | 2017 HK$ Million | Change | |
| Commercial | **2,344** | 2,283 | 3% | 95% |
| Offices and Industrial/Offices | **1,429** | 1,396 | 2% | 95% |
| Residential & Serviced Apartments | **325** | 303 | 7% | 85% |
| **Total** | **4,098** | 3,982 | 3% | |

* All occupancy rates stated therein were as of December 31, 2018.

### Commercial

With the contribution made by the positive rental reversions of our major tenants in recent years, revenue of the Hong Kong commercial portfolio increased 3% to HK$2,344 million. Overall occupancy slightly decreased two points to 95% owing to the impact of the renovation at The Peak Galleria, but was up two points on a comparable basis. Riding on the positive momentum of the retail market, total retail sales climbed 8% year-on-year.

Revenue of the **Causeway Bay portfolio** increased 4% to HK$634 million. Retail sales advanced 9% year-on-year. During the year, Kingston, which represents 25% of the retail space of our Causeway Bay portfolio, fully re-opened in the first quarter. This marked the completion of the three-year major asset enhancement initiative of Fashion Walk. The property is now transformed into a vibrant, integrated hub of fashion and lifestyle shopping and experiences, offering an all-new selection of shops ranging from active sports brands to chic modern furniture stores, as well as acclaimed gourmet choices.

Income of **Kornhill Plaza in Hong Kong East** advanced 6% driven by trade mix enhancement. The property was fully let. Retail sales increased 5% as a result of the good performance of the anchor tenants, including AEON STYLE and Grand Kornhill Cinema.

**Grand Plaza and Gala Place in Mongkok** generated 2% more revenue. Both properties were fully leased. Enhancement of the trade mix continued with the introduction of new healthcare and lifestyle brands to cater for the aspirations of style-seekers and the younger generation. More brand-new food & beverage tenants were also recruited. These initiatives made the two properties attractive shopping destinations for both locals and tourists. Total retail sales advanced 24%.

Revenue of **Amoy Plaza in Kowloon East** rose 5% driven by positive rental reversions and the opening of a new cinema, UA Amoy, in August 2018. This cinema has more than 600 seats in three houses, offering a unique entertainment experience to audiences with its stylish design, 4D technology, and food & beverage offerings. Continuing the tenant upgrade, more culinary choices were added to satisfy customers' pursuit of novelty and diversity.

**The Peak Galleria** continued its major renovation program in 2018. The program is to enhance the overall ambience of the mall with new shopping, entertainment and food & beverage options introduced for discerning customers and tourists alike. The whole of The Peak Galleria has been closed since October 2018 to expedite the renovation. While the first phase is expected to be ready for re-opening in the summer of 2019, certain restaurants are targeted to start operations in the first quarter of 2019.

### *Offices*

Revenue from our office portfolio in Hong Kong increased 2% to HK$1,429 million mainly driven by continuing positive rental reversions. Overall occupancy rate was flat at 95%. Our offices in Central and Mongkok recorded income growth of 4% and 7%, respectively, but revenue from Causeway Bay slipped 3%. The Hong Kong office rental amount accounted for 35% of our total Hong Kong leasing turnover.

To maintain the competitiveness of our properties, a refurbishment program of Gala Place in Mongkok was carried out in 2018, covering the façade, elevator lobbies and car park of the office tower. The entire program is scheduled to be completed in 2019 with minimal adverse impact on our revenue.

### *Residential and Serviced Apartments*

Residential and serviced apartments reported a 7% growth in revenue to HK$325 million, mainly attributable to the higher occupancy at Kornhill Apartments and The Summit.

## Property Sales

In 2018, we continued to sell down our remaining inventory as the Hong Kong residential market remained active with rising prices in the first half of the year. During the year, three semi-detached houses at 23-39 Blue Pool Road (2017: one house), nine units of The Long Beach apartments (2017: 226 units) and six car parking spaces at Napa Valley and Hanley Villa (2017: nil) were sold. Revenue from property sales amounted to HK$1,231 million, down 64% as far fewer residential units were sold against a year ago. Profit from property sales decreased 66% to HK$765 million. Overall profit margin was 62%.

In addition, 39 car parking spaces at The Long Beach, which are held as investment properties, were sold during the year. A total gain on disposal of HK$71 million was recorded as part of other income in the statement of profit or loss for the year ended December 31, 2018.

Other than the car parking spaces at The Long Beach, the remaining apartments and car parking spaces at Garden Terrace were also disposed of in two transactions. One transaction was made in April 2018 with completion in July 2018 and the other was made in December 2018 with completion in April 2019. According to accounting rules, these properties were reclassified as assets held for sale at the interim and financial year end reporting dates, respectively, at valuation with reference to the selling price. A gain of HK$82 million was included as part of the fair value gain of investment properties in 2018, compared to the valuation at December 31, 2017.

## Property Revaluation

As of December 31, 2018, the total value of our investment properties amounted to HK$144,572 million. The values of the Hong Kong portfolio and the mainland China portfolio were HK$68,344 million and HK$76,228 million, respectively. Our investment properties were revalued by Savills, an independent valuer, as of December 31, 2018.

Total revaluation gain of HK$4,298 million, representing a 3% increase in value, was recorded in 2018 (2017: HK$3,085 million). Properties in Hong Kong recorded a revaluation gain of HK$3,993 million and the corresponding amount for our mainland China portfolio was HK$305 million.

## Property Development and Capital Commitment

The total value of investment properties under development was HK$31,186 million. They represented mainland China projects in Kunming, Wuhan, Hangzhou and the remaining phases of the developments in Shenyang and Wuxi. The portfolio consists of malls, office towers, hotels and serviced apartments.

The construction work for Kunming Spring City 66 is progressing well on track. Spring City 66 is located at the center of Kunming's Central Business District and is the city's only large-scale complex connected to the metro interchange station. This mixed-use development, covering a total gross floor area of 432,000 square meters, will comprise a premier mall, a Grade A office tower, serviced apartments and car parking spaces. The mall and the office tower were topped out in September 2018. Leasing activities for the mall have commenced with encouraging responses. More than 70% of the leasable areas have been committed, including for some key anchor tenants. Both the mall and the office tower are planned to open in the second half of 2019.

Wuhan Heartland 66, a prestigious mixed-use commercial project with a total gross floor area of 460,000 square meters, will comprise a 177,000-square-meter mall, a Grade A office tower, serviced apartments and car parking spaces. The office tower was topped out in June 2018. The project will be completed in stages starting from 2020. Leasing activities for the mall have commenced.

The conversion of the top 19 floors of the office tower at Shenyang Forum 66 into a Conrad hotel is in progress. This five-star hotel will have 315 keys and a grand ballroom to accommodate more than 500 guests. The hotel lobby will be situated at the highest floor, offering a 360-degree panoramic view of Shenyang's skyline. The addition of this hotel will complement Forum 66's market position as the destination of choice for customers seeking high-end shopping, entertainment, business and hospitality experiences. The hotel is expected to open in the second half of 2019.

The second office tower at Wuxi Center 66 was topped out in June 2018 and interior fitting out works are progressing as scheduled. This Grade A office tower, built above the southeastern part of the Center 66 mall, has a total gross floor area of 52,000 square meters. There will be a linkage between the mall and the new tower, and a renowned cinema will be introduced to enrich the tenant mix and increase footfall. Leasing activities for the new tower have commenced and the tower will be ready for handover to tenants in the second half of 2019.

The master plan for Wuxi Phase Two development has been submitted for government approval. The project includes luxury serviced apartments and a small boutique hotel.

In May 2018, Hang Lung Properties Limited (Hang Lung Properties), the Company's listed subsidiary, successfully acquired a prime plot of land in Hangzhou for RMB10.7 billion. The site is located in the central business district of Hangzhou with well-established roads, other infrastructure, and a large existing catchment area. The acquisition marks a new milestone for our growth in mainland China, as the development of the site will create a strong synergy with our flagship projects in Shanghai and Wuxi in the Yangtze River Delta region. This premium site will be developed into a large-scale and high-end commercial mixed-use complex, comprising a world-class mall and office towers with a maximum floor area of approximately 194,100 square meters above ground. The architectural design work for the entire project is now underway. As well as focusing on the property's aesthetic features, we will continue to pursue the highest standards of environmental sustainability to fulfill our mission of "Build to Own and Build to Last". The project is planned for completion in phases from 2024.

The projects mentioned above represented the majority of the Group's capital commitments at the reporting date, amounting to HK$35 billion. They will be completed in phases over a number of years. The Group has a solid base of recurrent income and ample financial resources to meet the funding requirements of these projects and seize further growth opportunities when they arise.

In Hong Kong, we plan to re-develop the Amoycan Industrial Centre (AIC) in Ngau Tau Kok, in which Hang Lung Properties owns almost 85% interests. An application for a Land Compulsory Sale for the remaining interests in AIC was submitted to the Lands Tribunal in December 2017.

## Liquidity and Financial Resources

The major objective of our financial management is to maintain an appropriate capital structure with a high degree of agility. This is to ensure the Group will have sufficient financial resources to meet all obligations and commitments, and to capture investment opportunities for sustaining our long-term growth. To mitigate financial risks, multiple channels of debt financing have also been established. All related risk management, including debt re-financing, foreign exchange exposure and interest rate volatility, etc., are centrally managed and controlled at the corporate level.

### *Liquidity and Financing Management*

The cash flow position and funding needs are closely reviewed and monitored to ensure that the Group has a good degree of financial flexibility and liquidity. This is achieved by keeping sufficient cash resources and maintaining multiple channels of fund-raising in both Hong Kong and mainland China.

As of December 31, 2018, the Group had total cash and bank balances of HK$12,509 million (December 31, 2017: HK$22,223 million). All the deposits are placed with banks with strong credit ratings and the counterparty risk is monitored on a regular basis.

On debt portfolio management, the Group focuses on mitigating the re-financing and interest rate risks by maintaining an appropriate mix of fixed/floating rate borrowings, a staggered debt repayment profile and a diversified source of funding.

In February 2018, Hang Lung Properties was the first Hong Kong property developer to obtain approval from the National Association of Financial Market Institutional Investors (NAFMII) to establish an on-shore green bond issuance platform in mainland China (Green Panda Bonds). The total amount of the facility is RMB10 billion. A debut issuance of Green Panda Bonds of RMB1 billion with a tenor of three years took place in July 2018. The proceeds will be used to finance the construction of some projects under development in mainland China.

As of December 31, 2018, total borrowings of the Group amounted to HK$30,651 million, of which about 48% was denominated in RMB. The higher debt balance against a year ago was due to payments for the various projects under development in mainland China, including the partial land cost for the newly acquired Hangzhou site.

The following table shows the composition of our debt portfolio:

| | **At December 31, 2018** | | At December 31, 2017 | |
|---|---|---|---|---|
| | **HK$ Million** | % of Total | HK$ Million | % of Total |
| Floating rate HKD bank loans | **3,653** | 11.9% | 3,515 | 12.5% |
| Floating rate RMB bank loans | **13,490** | 44.0% | 11,814 | 42.1% |
| Fixed rate bonds | **13,508** | 44.1% | 12,710 | 45.4% |
| Denominated in USD | **7,832** | 25.6% | 7,816 | 27.9% |
| Denominated in HKD | **4,540** | 14.8% | 4,894 | 17.5% |
| Denominated in RMB | **1,136** | 3.7% | – | – |
| **Total borrowings** | **30,651** | 100% | 28,039 | 100% |

At the reporting date, the average tenor of the entire loan portfolio was 3.3 years (December 31, 2017: 3.2 years). The maturity profile was well staggered and spread over a period of 7 years. Around 76% of the loans were repayable after 2 years.

| | **At December 31, 2018** | | At December 31, 2017 | |
|---|---|---|---|---|
| | **HK$ Million** | % of Total | HK$ Million | % of Total |
| Repayable: | | | | |
| Within 1 year | **3,360** | 11.0% | 3,017 | 10.8% |
| After 1 but within 2 years | **4,057** | 13.2% | 4,845 | 17.3% |
| After 2 but within 5 years | **19,809** | 64.6% | 17,055 | 60.8% |
| Over 5 years | **3,425** | 11.2% | 3,122 | 11.1% |
| **Total borrowings** | **30,651** | 100% | 28,039 | 100% |

As of December 31, 2018, the Group's undrawn committed banking facilities amounted to HK$20,984 million (December 31, 2017: HK$15,009 million). The available balances of the USD3 billion Medium Term Note Program and the RMB10 billion Green Panda Bonds Program amounted to USD1,411 million and RMB9,000 million, respectively, equivalent to HK$21,297 million in total (December 31, 2017: HK$10,645 million).

### *Gearing Ratios and Interest Cover*

As of December 31, 2018, the net debt balance of the Group amounted to HK$18,142 million (December 31, 2017: HK$5,816 million). Net debt to equity ratio was 12.0% (December 31, 2017: 3.9%) and debt to equity ratio was 20.3% (December 31, 2017: 18.7%).

For the year ended December 31, 2018, the amount of total gross interest expense incurred was similar to the level a year ago at HK$1,431 million (2017: HK$1,350 million). The amount of finance costs charged to the statement of profit or loss for 2018 decreased HK$114 million to HK$1,180 million because of a larger amount of interest capitalization for the projects under development.

Interest income for the year was HK$465 million (2017: HK$567 million). The decrease was mainly due to a lower average balance of deposits.

The amount of net interest expense for 2018, i.e. the excess of finance costs over interest income, decreased to HK$715 million (2017: HK$727 million). The average effective cost of borrowings during the year was 4.8% (2017: 4.8%) given a portfolio of debts comprising 44% in RMB bank loan, 4% in RMB bond, 40% in HKD and USD bond and 12% in HKD bank loan.

Interest cover for 2018 was 7 times (2017: 10 times).

### *Foreign Exchange Management*

The activities of the Group are exposed to foreign currency risks mainly arising from its operations in mainland China and certain bank deposits denominated in RMB held in and relating to mainland China entities. There is also exposure in USD arising from the two USD500 million bonds issued. Appropriate measures have been taken to mitigate the foreign exchange risk exposure.

The currencies of cash and bank balances at the reporting date were as follows:

| | **At December 31, 2018** | | At December 31, 2017 | |
|---|---|---|---|---|
| | **HK$ Million** | % of Total | HK$ Million | % of Total |
| Denominated in: | | | | |
| HKD | **4,737** | 37.9% | 12,805 | 57.6% |
| RMB | **7,757** | 62.0% | 9,408 | 42.3% |
| USD | **15** | 0.1% | 10 | 0.1% |
| **Total cash and bank balances** | **12,509** | 100% | 22,223 | 100% |

*(a) RMB Exposure*

The RMB exposure of the Group is mainly derived from two respects of the operations. Firstly, currency translation risk arising from the net assets of our Mainland subsidiaries. Secondly, the RMB deposits held in and relating to mainland China entities which are primarily for the purposes of settling future construction payments in RMB.

As of December 31, 2018, net assets denominated in RMB accounted for about 57% of the Group's total net assets. The re-translation of these net assets denominated in RMB into HKD using the exchange rate as of the reporting date resulted in a re-translation loss of HK$3,864 million (2017: gain of HK$5,505 million), as RMB depreciated by about 4.6% against HKD compared to December 31, 2017. The re-translation loss was recognized in other comprehensive income/exchange reserve.

The Group's business operations and projects under development in mainland China are funded by cash inflow from Mainland operations and RMB borrowings, which form a natural hedge against our exposure to exchange rate fluctuation. We have adopted an enterprise risk management approach to mitigate the currency risks and practiced good disciplines of not taking any speculative position on the movement of RMB against HKD. Regular business reviews were made to assess the level of funding needs for our Mainland projects, after taking account of various factors such as regulatory constraints, project development timelines and the business environment. Appropriate modifications to the currency hedging program will be conducted in light of the outcome of the periodic reviews.

*(b) USD Exposure*

The USD foreign exchange exposure is related to the two USD500 million fixed rate bonds issued, equivalent to HK$7,832 million at the reporting date. The related currency exchange risk was covered back-to-back by two USD/HKD cross currency swap contracts. The swap contracts were entered into in order to effectively fix the exchange rate between USD and HKD for future interest payments and principal repayments.

The changes in the fair value of both swap contracts did not impact the cash flows and the profit or loss materially as they qualified for cash flow hedge accounting.

### *Charge of Assets*

Assets of the Group were not charged to any third parties as at December 31, 2018.

### *Contingent Liabilities*

The Group did not have any material contingent liabilities as at December 31, 2018.