Dear Stakeholders,

Over the past six months, the operating environment has been among the most challenging we have encountered in recent years. Our total revenue increased by 15% to HK$6.4 billion, driven by property sales of HK$1.2 billion. However, our main business — recurring rental revenues — slipped by 7% to HK$5.2 billion, while the underlying leasing profit attributable to shareholders retreated by 18% to HK$1.3 billion. We also recorded a valuation loss of HK$0.7 billion.

Although the decline in underlying net profit was mostly due to the drop in rentals received, it was also significantly impacted by the 46% increase in interest expenses over the same period in 2023 (calculated excluding capitalized interest). If capitalized interest had been included, gross finance costs would have increased by 19%. Also incorporated in the above figures is a 2.8% depreciation of the Renminbi (RMB) against the Hong Kong Dollar.

Even before the start of 2024, we expected that the first half of the year would be challenging, given the first half of 2023 leasing revenues were record-breaking. As a result, management worked hard to try to keep the gap as narrow as possible. Regardless, the market proved to be less cooperative than anticipated, and tenant sales in our Shanghai malls decreased by over 20%, while our ex-Shanghai mall tenant sales fell by low single digits. Considering the importance of our two Shanghai malls, this was enough to drag down our entire mainland China portfolio's tenant sales by 13%.

In the first few months of 2024, we — along with many of our luxury tenants — hoped the months that followed might help bring us back into positive territory. Unfortunately, by the second quarter, that looked increasingly unlikely, given weak sales in June. Anecdotally, luxury brands have now been revising down their 2024 full-year forecasts and have announced both delays and cancellations of new store openings. Thankfully, these have not hit us, as of yet.

The two main reasons for our decrease in underlying profits are straightforward: the reduction of tenant sales (resulting in reduced rental receipts), and higher interest expenses.

On the rental drop, there are several issues at play. The largest impact on our luxury sales over the past six months has been the cheaper Japanese Yen (JPY), which has driven outbound luxury tenant sales to Japan. In the first half of 2024, the JPY had devalued by 15%-20% against the RMB compared to the first half of 2023, making it that much cheaper to shop in Japan than onshore in China. The price difference widened to around 30% when tax refunds are taken into account. Partly as a result of that, in May 2024, Chinese tourist arrivals in Japan had increased by over 300% compared to May 2023. Alongside this focused increase in travel to Japan came a huge overall increase in outbound international travel by Chinese tourists, reaching nearly 400% of 2023 levels by the end of the first quarter. Considering the current trend, I do not expect this interest in outbound travel to lessen before the end of the summer.

The next most influential cause of our sales decline was the broad lack of consumer confidence across the market. One might understand this as the primary reason for the 4% fall in tenant sales in our malls outside of Shanghai, both luxury and sub-luxury. With economic uncertainty and tightened budgets, households have been reducing their discretionary spending. In the case of our malls, however, we believe this is more a reduction in visits or basket size rather than a "downgrade" in the quality of goods purchased. This national phenomenon might be reversed by a shift in sentiment or a shift in the macro environment, and most look to the government for signals of such. However, as of this writing, there has not yet been a compelling signal.

Finally, I want to reference a point made in previous discussions with investors and the media during the pandemic, which is the distribution of luxury purchases made by Chinese consumers onshore in mainland China, compared to those made offshore, overseas. One might consider this recent increase in outbound shopping a regression toward a mean. Ignoring the total size of the pie for a moment, Chinese consumers made only 35% of their luxury purchases "at home" on the Mainland before the pandemic. The other 65% was purchased offshore, for example, in Hong Kong, Europe, or Japan. During the pandemic, the onshore purchase amount increased to 100% since travel was impossible. Now that travel has resumed, it is fair to expect onshore Chinese luxury spending to normalize at a new level somewhere between 35% and 100%. Today, that figure sits at around 60%. This is a 40% drop from pandemic-era levels, and explains a significant portion of our sales decline. However, it is worth noting that the level of onshore luxury spending today is still over 70% above pre-pandemic levels. Although it is difficult to say where this number will normalize, I suspect that the worst will soon be behind us, given the previously cooped-up Chinese consumers will soon have had two full summers to travel and shop internationally; enough, I hope, to get the "travel bug" out of their systems.

The other side of our underlying net profit to shareholders equation is higher interest expenses. Unfortunately, interest rates remain more elevated than we had hoped. Although we would rather not increase our gearing or interest costs in this market, we have been well aware, for the past several years, that the Company would reach this level of debt, based on our regularly communicated capital expenditure plans.

Additional borrowings in recent years have been primarily associated with the remaining phases in Kunming, Wuhan, and Wuxi, as well as the construction of Westlake 66 in Hangzhou. Since the completion of Heartland Residences in Wuhan, The Aperture, and 228 Electric Road, we have stopped capitalizing interest on related construction loans, and those interest expenses now flow through our profit and loss statement. Combining these with higher Hong Kong interest rates explains the big jump in our interest costs. Based on the latest projections, we expect our debt and interest levels to peak in the mid-thirties percentage range over the next two years. We are comfortable with this.

Considering our higher interest costs, management has examined multiple options to reduce our debt burden, such as the active management of both capital expenditures and operating expenses. We said in January that our number one priority for additional cash was to pay down debt, followed by paying dividends, and then making new investments. Management envisions our priorities to remain similar until our debt and interest expense situations change.

While I do not see an immediate resolution to these macro headwinds, I am happy to report that the Company has not been sitting idle. We have made good progress on governance, management, operations, and sustainability, which will help us better withstand any external shocks and capture opportunities in the future. Some of you will have seen our appointment of Ms. May Tan to our Board in March. Ms. Tan is a seasoned finance executive with many years of executive and board experience. She is the former CEO of Standard Chartered Bank (Hong Kong) and has served on the boards of real estate, utilities, and financial services companies.

Operationally, two of the most important factors in a retail setting are occupancy and foot traffic. In both metrics, we have improved generally across the board. Our retail occupancy and foot traffic are as strong as ever, achieving a four-point rise in total occupancy against the same period last year across our malls, where we increased the number of luxury tenants by 2%. Similarly, average foot traffic is up across our mainland China portfolio. Despite a dip in sales, these fundamentals prove that our business remains on sound footing. Furthermore, we have increased both our ratio and our absolute amount of fixed rentals despite the period’s drop in sales rent.

I am also excited to announce that the first half of 2024 saw strong performance continue outside of Shanghai, broadening our income base and effectively awarding a strong "fourth leg" to our model. The first three legs are: 1) Hong Kong, 2) Shanghai malls, 3) mainland China offices, and now 4) ex-Shanghai malls. Each leg has a slightly different dynamic, so while they don't fully hedge each other, there is a broader base for future income stability.

Sustainability efforts and achievements have gone from strength to strength, with our partnership with LVMH entering its second year and both teams as energetic as ever. In addition to that unprecedented program, we have extended our sustainable tenant partnerships program, *Changemakers*. The program covers 16 tenants (both retail and office) across 14 properties in seven cities, together comprising a total leased area of more than 78,000 square meters. This represents a new milestone in our engagement with tenants and stakeholders to provide the most sustainable spaces in our markets.

Lastly, I will be unconventional and make a few broad observations on our share price — something we rarely do in writing, and even less so in this letter (for good reason). Exploring the details of micro-movements in the share price would be pointless, so I will focus on higher-order factors.

Many investors, including our major shareholders, have questioned why Hang Lung Group has performed so poorly over the past decade and a half. Our share price has underperformed the Hang Seng Index (HSI) and most of our peers, yet this certainly does not reflect our operational performance. In order of magnitude of impact, I have identified three primary reasons for this:

– Geography – mainly the rotation of capital out of China and China-related businesses

– Sectoral – the entire real estate sector's share price underperformance

– Comparables – the lack of easily comparable companies/competitors.

As those engaged in global markets know, the reason for capital rotation out of China, including Hong Kong, is primarily geopolitical. Of course, the country has not done itself any favors with its unpredictable and, at times, awkwardly timed regulatory changes, but feedback from analysts and investors points to geopolitics being the main reason. Related partly to the market and partly to the regulatory changes mentioned above, the residential real estate market has completely deflated in mainland China. Although we are not selling into that market, stock market indices and categories have lumped us with these hugely underperforming developers. Naturally, this has affected our stock price, despite us being a different type of company.

This brings me to my third point, which is that although our business is not uncommon in and of itself (there are many companies with luxury mall portfolios in China and others with high-end offices), we are quite unique in that no one else has the same level of concentrated exposure to these segments as we do. Our closest competitors have, in addition to their luxury malls, either a huge supply of mid-size and mass malls as well as residential real estate, or much more significant exposure to Hong Kong as a percentage of their revenues. Therefore, it is difficult to benchmark us against our peers in the market since there are no truly direct comparables.

Our business model is quite exceptional, and I am convinced that it is fundamentally sound. Regardless of the recent softening in consumption across China, I see no reason for Chinese consumers to suddenly turn their backs on luxury goods or to stop visiting our malls. In fact, if there is one macro trend that I would bet on, it is that Chinese consumers will continue to seek a higher quality of life, partly through more premium goods and services, which is precisely what our projects offer.

At the end of the day, these are the realities of the market, and management will do what we can to mitigate them.

As this is my first letter as Chair since taking on this role, I wish to express both my thanks and my appreciation to you, our shareholders, for your continued support of Hang Lung over the years. Rest assured that we will continue to work as hard as ever to be the best operator that we can be, and to earn your trust, confidence, and continued support. I also express heartfelt thanks to my colleagues, who continue to work tirelessly to deliver our promise of *Doing it Well*, in order to create the most compelling spaces for our customers.

Adriel Chan
Chair
Hong Kong, July 30, 2024