CHAIR'S LETTER TO SHAREHOLDERS

Results and Dividend

For the year ended December 31, 2020, revenue increased by 1% to HK$9,526 million against the backdrop of the coronavirus (COVID-19) pandemic. Purely owing to property revaluation loss, net loss attributable to shareholders was HK$1,541 million. Loss per share was HK$1.13.

When excluding all the effects of property revaluation, underlying net profit attributable to shareholders declined 25% to HK$2,834 million. Underlying earnings per share decreased likewise to HK$2.08.

The Board recommends a final dividend of HK63 cents per share payable on May 20, 2021 to shareholders of record on May 6, 2021. If approved by shareholders, total dividends per share for the year ended December 31, 2020 will be HK82 cents.

Business Review

Hang Lung Development Company Limited was founded by the late Mr. T.H. Chan on September 13, 1960. Its name was changed to the present one in 2001. As such, since my last letter of six months ago, we have celebrated our 60th anniversary.

On that day, our Executive Director Mr. Adriel Chan became Vice Chair of the Company and of our major listed subsidiary, Hang Lung Properties Limited (HLP). The move is part of a decade-long succession planning exercise, which the Board is very much involved in. In particular, I thank members of the Nomination and Remuneration Committee as well as several long-serving Independent Non-Executive Directors of this Company and of HLP.

Having been with the Company now for just over a decade, Adriel has been intimately involved in all key aspects of our business and has led many important departments. He has also worked with many of our outside stakeholders from the chairmen and CEOs of major tenants, service providers, and investors to relevant public sector leaders. Recently, I have asked him to share the responsibility of communicating with shareholders by writing a column "Vice Chair's Notes" to supplement my semi-annual letter to shareholders. Each time he will pick one to three areas of critical importance to the Company. For his inaugural commentary, he will address three issues: (1) Management's refreshed effort to "define" ourselves, i.e., our Vision, Mission, and Values, (2) Sustainability, and (3) Technology. This means that my letter can, and perhaps should, be shorter.

Our 60-year history can be more or less evenly divided into two parts. In the first 31 years, we operated exclusively in Hong Kong. Starting as a residential developer in our first decade, we took on commercial property ownership around 1971. We retained this model until the time I took on the chairmanship in January 1991. One of the first things I did as the Chair was to study the Mainland market. Frankly, I knew very little about the country until that point. In 1992, we decided to enter that market and our business there has since thrived.

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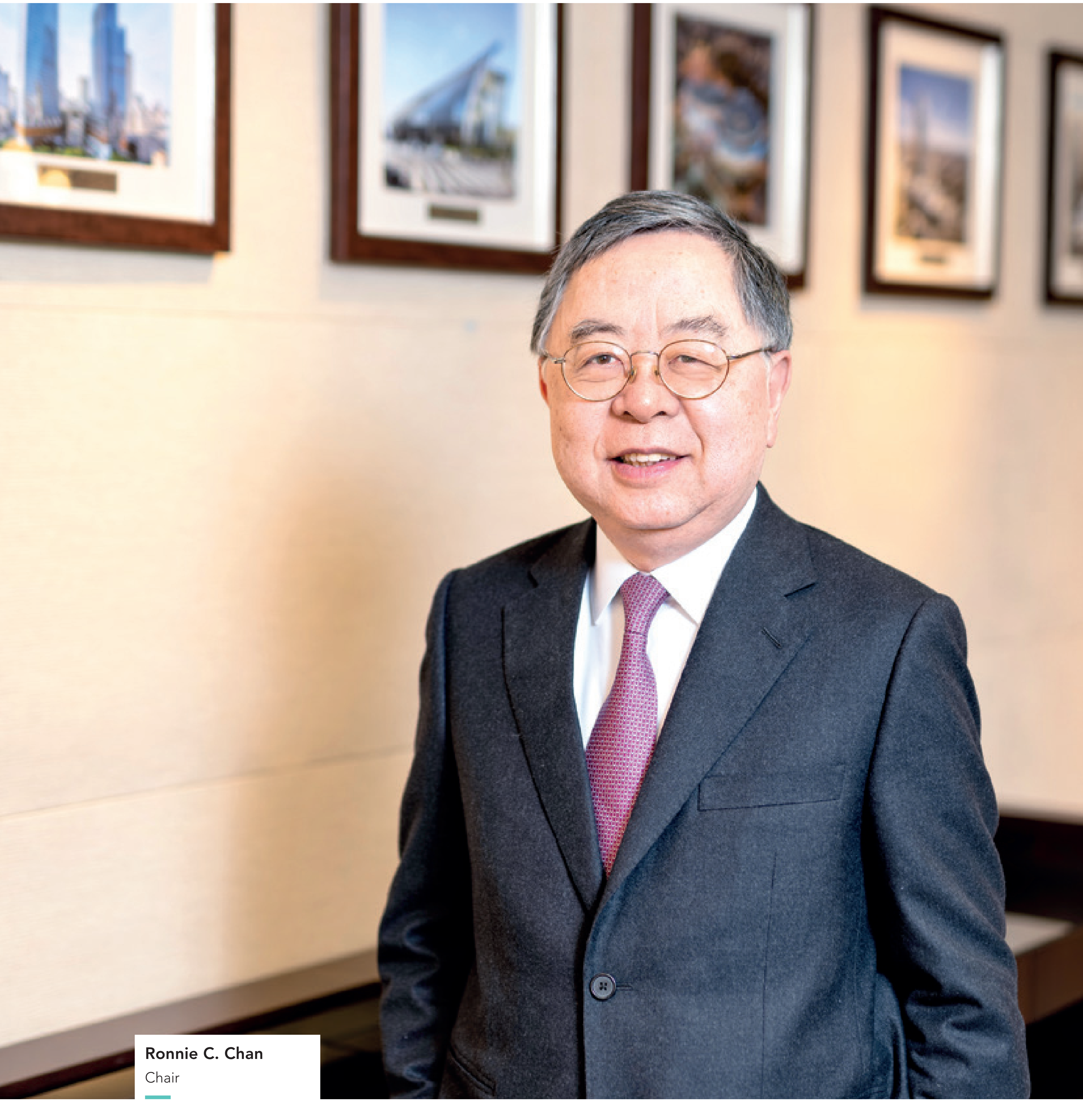


Ronnie C. Chan
Chair

What does the future hold? As businesspeople, we cannot change the social environment surrounding us. We can only respond to it – and respond we must if we want to survive. With hindsight, our founder choosing Hong Kong real estate was a brilliant decision, as was our entering the Mainland market in 1992. More specifically, our focus on high-end commercial rental was without doubt the correct one. I believe that for the foreseeable future, it will still be the best segment of the real estate industry for an organization like ours. In the past, I have written on its fundamental attraction and will not repeat myself here. Suffice it to say that former socioeconomic developments have heavily favored this business. It seems certain that the same condition should continue in the foreseeable future. Our dependence on it will grow over time.

To say that we were confident about this sector 30 years ago would be an exaggeration. After the first two to three years of research and experimentation, we knew what we should not be in. To us, mass residential, industrial buildings, and low-end commercial properties were unattractive. What were left were luxury retail malls and high-end offices.

But how lucrative it could be was not something we foresaw at the time. When we bought, in December 1992, the piece of land in Shanghai which is now Grand Gateway 66, China was still very poor. Even in Shanghai, which historically was the most modern of the Mainland's cities, citizens had never seen a mall, let alone a truly luxury one. Louis Vuitton, Chanel, Gucci were names then foreign to them. Would they accept such overseas brands, and more importantly, would they ever have enough money to buy them even if they wanted to?

In fact, back in the early 1990's, we were not even sure if the Chinese government's experimentation of Reform and Opening-up would succeed. After all, only a few years before, social turmoil had engulfed 77 cities around the country. Ostensibly, an ideological battle was still ongoing for the souls of her citizens – would they choose economic development, or remain entangled in endless political struggles? The answer was by no means obvious at the time.

There was no denying that Mr. Deng Xiaoping's Spring 1992 trip to southern China revived his reform efforts. It offered us some solace. The will of one old gentleman turned the tide. His reliance on capable bureaucrats like then Premier Zhu Rongji bolstered confidence. The sheer multitude of changes that took place during the 1990's was mind-boggling. Political struggles were forcefully kept from bubbling to the surface so that reform could proceed peacefully. That was one of the most amazing chapters of human history and not just Chinese history. Human history is full of accounts of very bad things happening all of a sudden. Seldom do we witness so many good things in such a short period of time. Thus, a socioeconomic miracle was born.

With hindsight, a few cultural and historic factors were at play. Without them, the miracle could not have happened. (This is why its emulation elsewhere in the world is doubtful. They may not have sufficient amount of the right mix of factors.) First, Confucian ethics was critical – hard work, family cohesion, and emphasis on education. The resulting high savings rate and the willingness for delayed gratification were absolutely necessary. The unimaginable suffering, both physical and psychological, endured during the decade-long Cultural Revolution instilled in the average citizen a powerful desire for stability, if not prosperity. The role of Hong Kong should also be mentioned in this regard. The Reform and Opening-up would have proceeded without this former colony (then still was until 1997) but progress would be much faster with it.

During the first decade of tackling this market, we began to observe several phenomena later proved to be critical to the country's – and our – success: a government that has held steady and kept society in relative peace; governance at all levels improving; export fast growing; average salaries rapidly advancing; and the mindset of the educated becoming more internationalized. All these were vital signs to us. At the same time, we were increasingly convinced, not only of the presence of a fast-developing luxury goods market, but also of its huge potential. The combination of these favorable factors outside of and domestic to our business was powerful.

Consider this seldom mentioned development which is very significant: the amazing improvement of the average citizen on so many fronts. Everyone seemed to have learned so much in such a short time. Take one trivial observation which is not trivial to us at all. In the span of 10 to 15 years, Chinese shoppers went from not knowing how to pronounce many top brand names to being the most discerning and sophisticated consumers of those brands. Moreover, that cohort is now huge, probably the biggest of any country in the world, and brands are stocking their stores in China with the latest and the most complete lines of products second to none.

Today, fashion houses are very busy opening new shops all over China. Many of them overextended prior to the 2011-2017 bear market and had to quickly close down many stores. Their headquarters overseas froze all leasing decisions. The only decision their regional offices could make was to get out of leases. Yet, in the second year of recovery, i.e., in 2019, they all woke up to the renewed vigor of the China market and began to quickly expand again. Given our mall portfolios, we have been one of the beneficiaries. We are already the biggest landlord in China to many of the world's top international brands.

Next year will be our 30th year in mainland China. We are glad that a decision was taken, back then, to be among the first to enter that market. Today, we will redouble our efforts there to create further shareholder value. We believe that at least in the coming decade or two, it should remain a relatively stable and steadily growing market for our business. If one is in the real estate sector like us, I can hardly think of a better place to invest. The economy is huge and fast expanding, especially its personal consumption market. That suits us well.

It is very likely that the 2020's will prove to be a harvesting time for us. The existing pipeline will ensure good growth for the next seven to eight years. We are now looking for other opportunities that will extend our trajectory by a further five to six years.

Troubles in the China-U.S. relations may, in fact, help us as China rushes to develop further her domestic economy. As I have written previously, COVID-19 and the 2019 riots on the streets of Hong Kong have also aided the repatriation of luxury spending. As such, all stars seem to be aligned for our Mainland business.

We do not mind being so dependent on this market, since China is already the world's second largest economy and will likely become the largest before this decade is over. She already is, in purchasing power parity terms. To miss this is to miss the biggest opportunity mankind has seen in many decades. We should not do that. For almost 30 years, the company has built much expertise, a competent team, an excellent reputation, a valuable brand, as well as a portfolio of superb properties. As long as the market behaves more or less as we expect, our future should be bright. We are not merely building top-line revenue as new developments are added; our track record has shown our ability to produce profit as well. I am excited about our future.

While our outlook for the Mainland market is quite positive, the same cannot be said of our Hong Kong rental operations. For the foreseeable future, it will be a drag on our overall results. Worse yet, it is not something that we can remedy. For now, our economy has been damaged by the anti-government politicians. Frankly, I doubt if many of our local citizens are yet aware of this fact. But such is always the case everywhere. Most people will only wake up when things are irreversibly damaged. Moreover, many are unwilling to acknowledge the true reason for trouble if it is of a political nature. Such is our situation today. It is always someone else's fault. Human history is littered with such tragedies of economies in a downward spiral. A prime case is Taiwan in the past 20 some years. Now our city is undergoing "Taiwanization." Frankly, we have been moving in that direction for well over a decade.

Can the downward trend be reversed? I am skeptical. Any positive turn for our economy must, one way or another, involve Beijing playing a major role. But will they make such a move? It depends primarily on the Hong Kong people. If we remain a political thorn in the eyes of Beijing, then why should they hasten to help us? Our usefulness, as a territory to the nation, remains, but is diminishing. In fact, the burden we place on the nation has been on the rise, no small thanks to local sentiments fanned by international forces. Unless and until our society is willing to squarely face this fact, our economy will continue to suffer.

We as businesspeople can only respond to such events, which are much bigger than ourselves. Company executives must be objective, unflappable, and make decisions with a clear head. When times are good, our decisions take into consideration the interests of all stakeholders. The fact that we have won many, if not most, corporate governance and ESG (Environmental, Social and Governance) awards in our sector for many years attests to this. History has shown that we are among the most socially conscientious real estate companies in Hong Kong. But in extraordinary times, actions may have to be taken primarily to preserve the interests of shareholders.

In 2020, our Hong Kong rental revenue fell by 9%. COVID-19 was the immediate cause, but if it were the only reason, then we could be confident that business would one day recover. In fact, when it does, history tends to show that it would rebound with a vengeance. However, the public health threat came on the heels of seven months of riots in 2019, which had already pummeled rents. As such, we have to face the fact that our economy has been crippled, perhaps for good. The question now is how to respond. With real estate being an illiquid asset, there is not much that can be done in the short run. Nevertheless, be assured that your Management is studying the situation and will take action as and when we deem most appropriate.

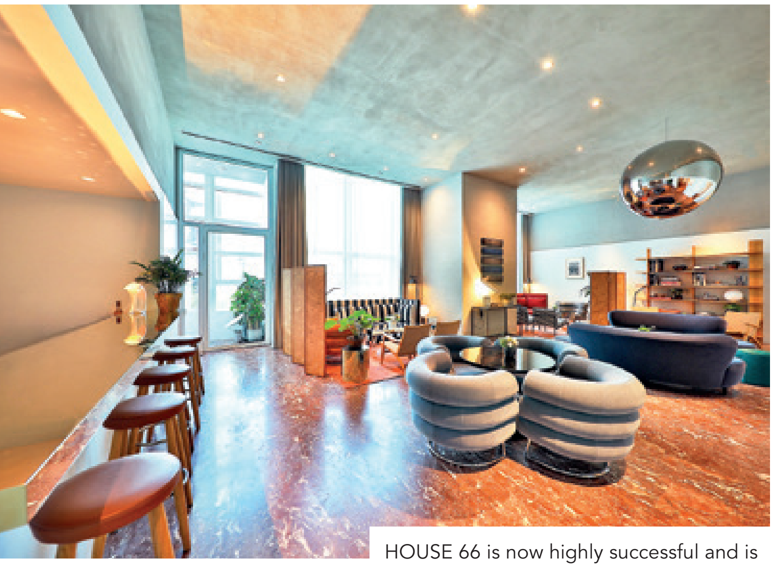
Due to the pandemic, we were unable to sell down houses on Blue Pool Road. There are, however, prospects and we are following up. With such big-ticket items, patience is required.

When I wrote six months ago, we already detected a trend developing on the Mainland. Now we are very sure. Retail sales at all our malls improved as 2020 wore on. However, the performance of luxury versus sub-luxury differed greatly. During February and March, everyone was hurt when COVID-19 ran wild. But as it was quickly brought under control, the high-end fashion market immediately took off, so much so that tenant sales caught up in the second quarter and all our luxury malls together ended the first half of the year with an increase of 21% over the same period in 2019. (Our two Shanghai properties were up 15%.) In the same period, our sub-luxury centers saw a drop in retail sales of 34%. In the last six months of the year, our five-star malls almost doubled sales from the year before – sales rose 98%. The four-star facilities also improved tremendously, but with sales still 4% below that of 2019.

Forum 66, Shenyang

For this discussion, luxury centers included the two in Shanghai, Center 66 in Wuxi, and Forum 66 in Shenyang. In the other category were Palace 66 in Shenyang, Parc 66 in Jinan, Riverside 66 in Tianjin, and Olympia 66 in Dalian. The last mall was migrating to luxury status during this period, a process that will only reach completion by the end of this year, and as such, for the year in review, it was categorized as a sub-luxury facility. Spring City 66 in Kunming was inaugurated in August 2019 and was not included in the assessment.

Since COVID-19 hit early in the year, a better comparison of our real performance was the second half of 2020 compared to the second half of 2019. The worst performing of our sub-luxury properties was Olympia 66 in Dalian; it did 11% less business. But that was partly due to the changing of tenants to top fashion brands. So, the truly weakest performer was Riverside 66 in Tianjin, where retail sales fell 7%. Parc 66 in Jinan sold 2% less, and Palace 66 in Shenyang achieved 2% more sales. Our top-end malls, on the other hand, soared. Center 66 in Wuxi jumped by 125% in sales. Plaza 66 and Grand Gateway 66 in Shanghai, respectively, grew by 97% and 71%. It should be noted that Grand Gateway 66 only completed its Asset Enhancement Initiative (AEI) last September, but business was already booming. Forum 66 in Shenyang took in 31% more, and Spring City 66 in Kunming, less than two years old and so without comparison, saw sales leap.



HOUSE 66 is now highly successful and is appreciated by tenants and shoppers alike

This set of results proves to us conclusively that our five-star malls outside Shanghai perform exactly like the two in Shanghai. The divide is not Shanghai versus non-Shanghai; the divide is luxury versus sub-luxury. Top-end facilities behave similarly wherever they happen to be. That said, what unit rents a property can command depends on the amount of retail sales it can generate. As such, to be the number one in Shanghai (Plaza 66) is far superior to being the number one say in Wuxi (Center 66). The market and our share therein matter.

In this regard, Heartland 66 mall in Wuhan, which will open in less than two months, should quickly become the leader in the luxury fashion market for this economically vibrant city. It will be the seventh top-end mall in our portfolio of ten.

In a sense, we are not here to maximize rental revenue for ourselves. Instead, our task is to bring in the most business for our tenants. Only when they achieve higher sales will they be able to pay us higher rents. Our interests and those of our tenants are very much aligned. This is why, in recent years, we have expended much effort in building a cross-portfolio Customer Relationship Management (CRM) program HOUSE 66. It is now highly successful and is appreciated by tenants and shoppers alike.

One number can reveal a lot about our business. Our Plaza 66 in Shanghai alone achieved almost RMB11 billion, or about HK$12 billion in retail sales last year. That is almost twice of what all our Hong Kong shops took in combined. If we compare only the second half numbers, Plaza 66 then did 2.4 times. In a few years, sales at Grand Gateway 66 in Shanghai may also approach our Hong Kong total. This clearly demonstrated the personal consumption power of the Mainland. Consequently, as in the past two decades, our future efforts will focus up north. It does not mean that we will give up Hong Kong. As before, we will only pick opportunities on a very selective basis.

Plaza 66, Shanghai

One such opportunity presented itself in the second half of last year. As regular readers of this letter know, the only sector that we like in Hong Kong is luxury housing. It is not a big market, but it can be rather lucrative. Since the land element is so big as a percentage of total cost, buying correctly is the key to future profitability. Given the terrible economic conditions Hong Kong was (and is) in, this was the right time to strike out. Local developers tend to shy away from acquisitions during times when sentiments run negative, so we expected lighter competition. We were proven correct.

Buying when others do not has been a hallmark of ours for the past three decades. As such, no one should be surprised that we won the land tender for luxury housing in Shouson Hill on the south side of Hong Kong Island. The fact is that we regularly bid for land in Hong Kong but never win until the bear market arrives. Frankly, I would be hard-pressed to find a better time to buy. The price at which we won was almost 40% cheaper than the piece next door, sold some 18 months prior. And ours is far superior, because unlike theirs, our land has a full sea view and clean and simple developmental conditions. It measures approximately 8,800 square meters on which we can build slightly over 4,400 square meters of houses. Accommodation value was HK$583,000 per square meter.

Certain complications, however, surfaced after our winning the tender. We were notified that the seller, being a foreign sovereign state, had not completed all the necessary diplomatic protocols before selling. It will take some time to remedy, but we are confident that the problem is readily resolvable. Given the attractiveness of the price and the low-interest-rate environment, we can afford to wait. It is an asset almost beyond compare.

In writing this semi-annual letter, I am always confronted with a dilemma: how much I should repeat certain important aspects of the Company that was previously written. There are always new readers of this platform who do not know our history, and some parts of which are critical to understanding the Company. One such example is mentioned above – our attempts to time the acquisition of land. There are many strategies real estate firms can deploy and a good number can be effective. We have one of such which is perhaps somewhat unique in Hong Kong. Let me briefly describe.

Partly because of not paying sufficient and correct attention to the timing of land purchases in the 1970's, we missed many excellent opportunities. Worse yet, for the same reason, we got into serious financial difficulties in the early 1980's. From the 1990's onwards, our stance has changed, be it with regard to acquisitions in Hong Kong or on the Mainland. This new orientation has served us well.

Here are a few notable examples. In late 1992, we bought what is now our headquarters building called Standard Chartered Bank Building. The seller was then in serious financial trouble and the transaction was extraordinarily complicated. No one apparently dared to touch it and we picked it up for a song. The price paid is a fraction of what it is worth today.

Around the same time, we acquired several investment properties at attractive prices. Some we have since sold for substantial profit, while others are still in our portfolio.

In the mid-1990's we bucked the trend and became the only major local developer who sold investment properties rather than bought land. Prices were frankly at dizzying heights as far as we were concerned. That, together with appropriate financial exercises, gave us a lot of cash when the Asian Financial Crisis (AFC) hit in July 1997. We waited another 20 months before pouncing on the land market in the depth of the crisis. We bought several excellent pieces almost in the total absence of competitors. About HK$25 billion was later made from those developments alone.

In the 2000's, we turned our attention to Mainland commercial land outside Shanghai. Between 2005 and 2009, we quietly picked up seven of the best located plots in good tier-two cities, at what today must be considered amazingly attractive prices. All have risen by manyfold. In the 2010's we continued to hunt for opportunities and bought land for three outstanding developments in Kunming, Wuhan, and Hangzhou. Even those three plots of land have all appreciated in value. This strategy of timing the market for land acquisition has served us well, and we hope to do more.

Prospects

With or without COVID-19, China's economic path forward seems quite certain. As much as possible, Beijing today, as before, will focus on domestic affairs, chief among which is to improve the quality of her economy. She must wean herself off foreign dependence, especially in technology. This is not China's choice, but given American tactics against her, she has no alternative. Although it will be painful for the immediate term, it is actually a good thing for the country for the longer term. The U.S. is absolutely helping – shall I say forcing – the country to improve the quality of her economy. What was meant to slow China's development will end up hastening her ascendency.

The benefits of an economic quality upgrade are incalculable. Consider the fact that China is already the world's first major cashless society. Living in Hong Kong, I feel awfully backward when I enter the Mainland and fumble with my cash to pay for my taxi ride, my Starbucks coffee, or any number of goods or services. Annually producing more engineers than any country in the world by a wide margin, and with an army of hungry young entrepreneurs ready to pick up new technologies and ideas and turn them into money-making enterprises, the future of China seems unstoppable. Any foreigner who has lived in Beijing or Shanghai for a while over the past few years knows what I am talking about. One can smell or even touch the excitement in the air.

All that will keep China's economy rolling. New jobs will be created, and salaries will continue to rise, although the rate may slow a little compared with the past. Enough momentum in technology and the economy has been established. As long as society remains relatively peaceful, the country should be able to stay on her feet. In fact, foreign pressure will only unify the people more behind their leaders, and so help keep society stable.

I am always skeptical regarding the assertion that what happened to many Latin American countries, the middle-income trap, will be the fate of China. If one knows anything about China's educational and technological landscape, he or she may share my view. Corruption can never be fully eradicated anywhere in the world; it just manifests itself in different forms in different places. It is less blatant in advanced democratic countries because it is not called by that name. What is critical is whether corruption becomes detrimental to a government or to an economy. To be fair, China has been improving tremendously in this regard in the past few decades, and especially in the past few years. From where will the middle-income trap arise? Could it be another illusion of the West which will lead to another delusion?

If this analysis is anywhere close to the truth, then the economy will do acceptably, and personal consumption should steadily rise. We are indeed operating in one of the sweet spots – high-end spending. As I have written previously, over the first 30 years of the country's reform (from about 1980), people migrated from being "have-nots" to "haves". In the past decade and in the coming few, the story will be "what do I have" or "how good are the things I have". Every developed Asian economy in the post-World War II era followed the same path, and so will China. She is already well on her way.

We have now operated commercial properties outside Shanghai for about a decade. Two-thirds of that time was in the face of strong headwinds (mid-2011 to the beginning of 2018), while the remaining one-third until today is being propelled by a tailwind. Strangely, even the pandemic and rough China-U.S. relations have turned out to be favorable for us. So, what will our future likely hold?

I expect all of our existing Mainland projects to significantly improve their profitability in the next few years. The only exception may be Parc 66 in Jinan due to AEI which begins this year. In Shanghai, our two complexes should continue to advance in rental revenue this year. In particular, I watch Grand Gateway 66 with keen anticipation. For the past three-and-a-half years, various parts of the mall and office were under AEI. Inasmuch as we did our best to minimize disruption to retail tenants, it is inevitable. Only last September did we complete the work, and so 2021 will be the first full year as a truly luxury facility. The many upgrades to top fashion brands are bringing higher rents, and all our tenants, old and new alike, are basically pleased with our efforts.

Our other luxury properties outside Shanghai may perform even better. Center 66 in Wuxi should continue to grow rents nicely, with Forum 66 in Shenyang increasing almost as much. The top performer may well be Olympia 66 in Dalian and especially Spring City 66 in Kunming. Our sub-luxury malls are also expected to perform quite well this year.

Our Mainland offices are expected to fill up gradually. Rents will hopefully hold steady.

The Hong Kong economy is still struggling. I expect unemployment to go above 7% which is highly unusual for this town. Frankly, it may inch up further, if the pandemic is not quickly brought under control. Tourism will not recover so easily, and retail sales will still be sluggish. As such, I expect retail and office rents to remain weak as vacancy rises a little.

Grand Gateway 66, Shanghai

It is instructive to examine the last big downturn in the aftermath of the 1997-2002 AFC. Back then the market eventually recovered; this time we may not be as fortunate. In 2001, China joined World Trade Organization (WTO) which greatly benefited her economy. Her digital economy also took off and all these helped Hong Kong a lot. Mainly to help us, Beijing starting in 2003 allowed many more tourists to our city. That became a main cause for our economic vibrancy for some 15 years. Unfortunately, due to local rioters of 2019, Hong Kong's relationship with Beijing is fundamentally changed. The extent this new political reality affects our economy is yet to be fully seen.

In any event, during AFC, our total rental revenue fell for four consecutive years and then moved sideways for two more. By 2002, the overall economy had already fully recovered, but our rental income still lingered at the bottom. It took a total of 10 to 11 years until 2008 before total rents returned to 1997 levels. Our annual rent for the five years of 2000 to 2004 was only about three quarters of the amount in 1997. In other words, total rents fell by approximately 25% from pre-crisis levels and stayed that way for five years. I fear that it may be worse this time.

All that being said, we will continue to sell houses on Blue Pool Road. For now, the luxury housing market is slow. The local wealthy are cautious about leaving their homes, and potential Mainland buyers cannot come to Hong Kong without a 14-day quarantine. With the vaccine, things will hopefully change later this year or next, although no one can predict the timing.

It is most likely that the total Hong Kong rents collected this year will fall a little more. The loss should be easily compensated for by the expected growth on the Mainland. All in all, we should see an overall healthy increase in rental profit. Total profit will depend on the number of residential units we can sell.

Our 60-year history has been not bad, but I anticipate even better days in the coming five to ten years.

Ronnie C. Chan
Chair
Hong Kong, January 28, 2021

Addendum

On February 9, all the diplomatic obstacles to the Shouson Hill site acquisition, which we won in a tender last September, were satisfactorily resolved. Working with the seller, the transaction was consummated at noon today. This is a welcome development.

Ronnie C. Chan
Chair
Hong Kong, February 25, 2021