2 Business Performance

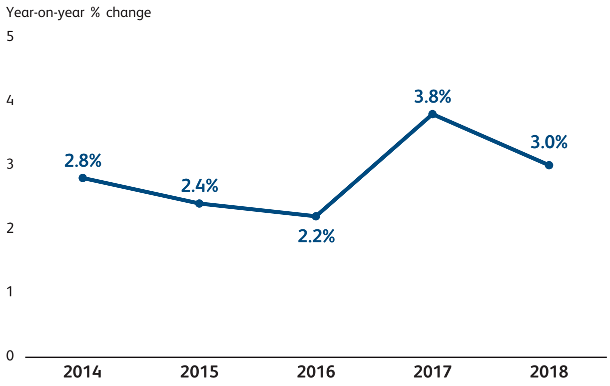

THREE

The Marketplace

Hong Kong Economy

The Hong Kong economy grew 3.0% in 2018. With 4.1% growth recorded in the first half of the year, growth slowed to 2.8% and 1.3% in the third and fourth quarter of the year respectively. This was mainly due to the deteriorating global environment stimulated by the China-US trade war during the latter half of the year, which also impacted other key economic statistics. Imports and exports of goods both showed a marginal drop during the fourth quarter following positive growth in previous quarters, with a full year increase of 4.9% and 3.5% respectively. Exports of services grew by 4.9%, which was mainly due to the increase in visitor arrivals. Investment expenditure grew moderately by 2.2%, slowed by dampened sentiment during the last quarter of the year. Private consumption expenditure increased by 5.6%, which was supported by a favourable employment market.

Real Gross Domestic Product Growth*



* In chained (2016) dollars

Source: Census and Statistics Department (data as of February 2019)

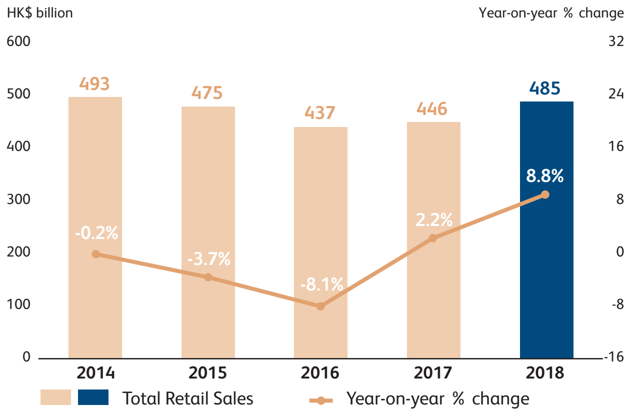
Retail

Following the rebound in the Hong Kong retail market in 2017, consumer sentiment continued to be positive. This benefitted the retail sales market in the first half of 2018, with growth of 13.4% being recorded in Hong Kong retail sales versus the same period in 2017. However, due to various adverse factors such as the China-US trade war, RMB depreciation as well as the interest rate hike, growth in Hong Kong retail sales during the second half of 2018 slowed to 4.3% when compared to the same period in 2017. The overall growth in Hong Kong retail sales was 8.8%.

During the year, the number of visitor arrivals grew by 11.4%. Since the new infrastructure linking Hong Kong to Mainland China became operational, the number of visitors from the Mainland soared by 14.8%. These visitors were one of the core factors in the overall retail sales growth. Local consumers also contributed to the retail market upturn, as is shown by the increase in private consumption expenditure.

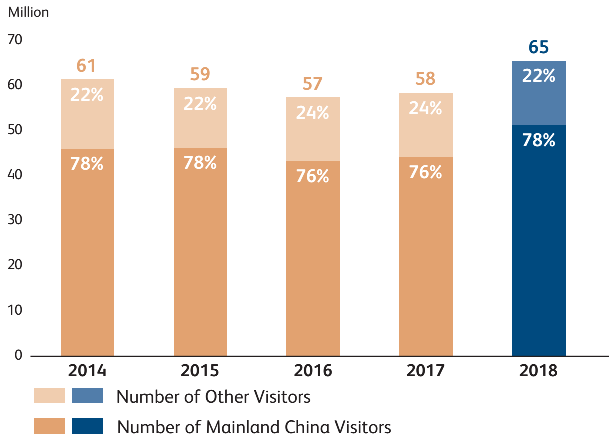
The growth in Hong Kong retail sales extended to most trade categories. However, some categories recorded better year-on-year growth than others; for example, jewellery, watches and clocks and valuable gifts (up 13.7%), commodities in department stores (up 9.6%), and medicines and cosmetics (up 14.3%).

Hong Kong Total Retail Sales



Source: Census and Statistics Department (data as of January 2019)

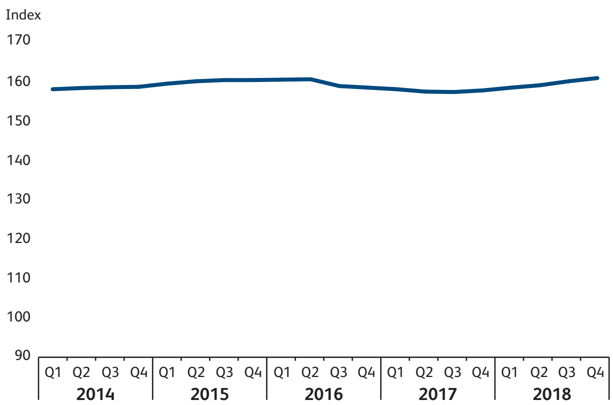
Total Number of Visitors



Source: Hong Kong Tourism Board (data as of January 2019)

According to Jones Lang LaSalle, rents for retail premises in premium shopping centres increased by 2.0% overall.

Premium Prime Shopping Centre Rental Index (2009 Q4=100)



Source: Jones Lang LaSalle (data as of January 2019)

© Photographed by Geoff Letchford

Overview

Business Performance

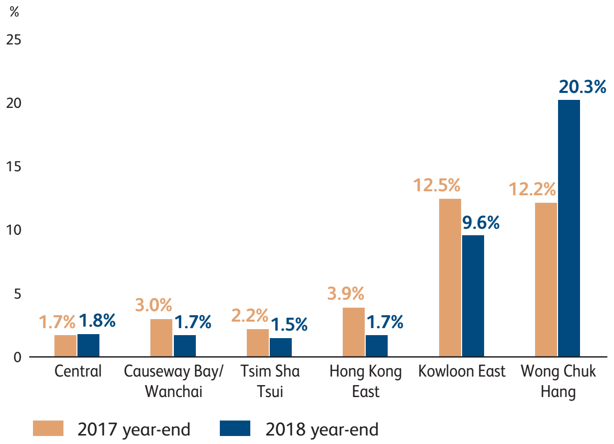
Corporate Governance

Financial Statements and Valuation

Office

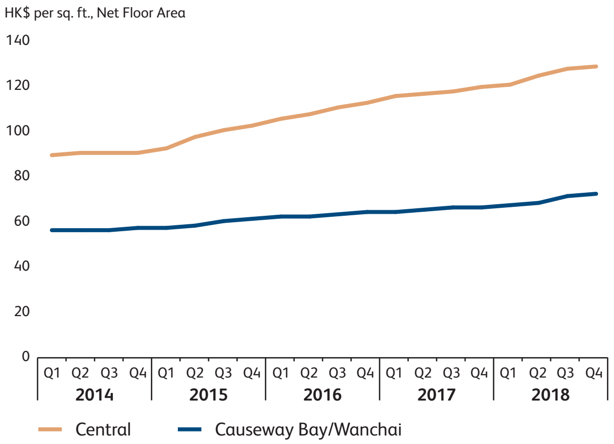
Grade "A" office rents in general continued to increase during 2018, being primarily driven by the demand from Mainland Chinese firms as well as the growing number of co-working operators. Spot rents in Central and Causeway Bay in 2018 showed a solid increase of 8.0% and 8.6% respectively over 2017. During 2018, Mainland China companies took up about 29% of new lettings in Central. Analysed by locations, both the traditional and new commercial areas saw a decrease or on par in vacancy rates at the end of 2018 when compared to 2017. The exception was Wong Chuk Hang, which showed an increase mainly due to new supplies. Strong demand for office space in Central was maintained. With limited supply and ongoing rental increases, the decentralisation trend continued as banks and professional firms as well as multinational corporations moved to other areas like Causeway Bay, Hong Kong East and Kowloon East. Co-working operators expanded into Grade "A" offices to provide premium services, a trend that resulted in the occupancy of a considerable amount of office space.

Grade "A" Office Vacancy Rate in 2017 and 2018



Source: Jones Lang LaSalle (data as of January 2019)

Grade "A" Office Monthly Net Effective Rental Value



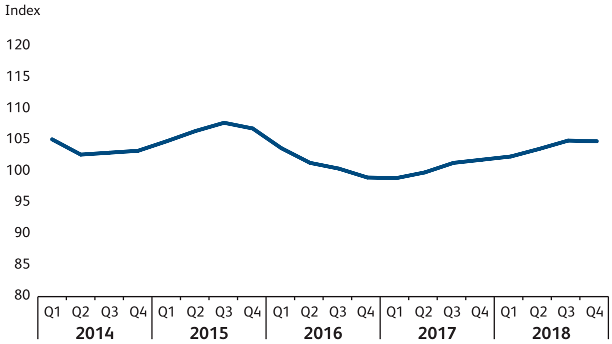
Source: Jones Lang LaSalle (data as of January 2019)

Luxury Residential

Luxury residential rents began to pick up in 2017 and the trend continued in 2018. However, the traditional luxury market is facing headwinds due to unfavourable economic outlook and tight housing budgets in multinational corporations.

According to Jones Lang LaSalle, luxury residential rents increased 2.9% as compared to 2017.

Luxury Residential Rental Index (2009 Q4=100)



Source: Jones Lang LaSalle (data as of January 2019)

Management's Discussion and Analysis

Strategy

The Group is committed to providing our shareholders with sustainable returns from our property portfolio, which is predominantly located in Hong Kong's prime commercial area of Causeway Bay. This district will remain the core of our investment and operational focus. The Group also continues to seek investment opportunities beyond our core geographical area.

We continuously strive to enhance the value of our properties through asset enhancement, repositioning and redevelopment. We also focus on curating the contents of the Lee Gardens community for our tenants and other stakeholders. We are proud of our team of passionate, responsible and forward-looking professionals who strategically plan and manage our portfolio while ensuring everything we do is underpinned by sound financial management.

Review of Results

	2018 HK$ million	2017 HK$ million	Change %
Turnover	**3,890**	3,548	+9.6
Recurring Underlying Profit	**2,536**	2,349	+8.0
Underlying Profit	**2,536**	2,491	+1.8
Reported Profit	**6,033**	3,636	+65.9

The Group's turnover in 2018 was HK$3,890 million, an increase of 9.6% from HK$3,548 million in 2017, mainly attributable to the meaningful contribution from Lee Garden Three and the strong performance of the office sector.

Recurring Underlying Profit, the key measurement of our core leasing business performance, was up 8.0% to HK$2,536 million (2017: HK$2,349 million). Our Underlying Profit in 2018, was also HK$2,536 million, up by 8.0% from 2017 on a normalised basis after excluding the one-off compensation received from a retail tenant in 2017. Basic earnings per share based on Recurring Underlying Profit and Underlying Profit correspondingly rose to HK242.40 cents (2017: HK224.68 cents and HK238.26 cents respectively), up 7.9% and 1.7% respectively.

The Group's Reported Profit for 2018 was HK$6,033 million (2017: HK$3,636 million). A fair value gain of HK$3,532 million (2017: HK$853 million) on the Group's investment properties' valuation was the key contributor. As at year-end 2018, the external valuation of the Group's investment property portfolio increased by 6.9% to HK$77,442 million (2017: HK$72,470 million). This reflected a combination of factors: a generally positive rental outlook for our core portfolio, and a number of asset enhancement works completed. The capitalisation rates used in valuing each portfolio remained unchanged from those used as at 31 December 2017.

Review of Operations

Hysan's portfolio of retail, office and residential investment properties has a total gross floor area of approximately 4.5 million square feet. As at 31 December 2018, about 85% of the Group's investment properties by gross floor area were retail and office properties in Causeway Bay. The remaining 15% was represented by residential properties mainly in the Mid-Levels.

The turnover of each sector is shown as below:

				Contribution to Turnover	
	2018 HK$ million	2017 HK$ million	Change %	**2018 %**	2017 %
Retail sector	**1,923**	1,925	–	**49.4**	54.3
Office sector	**1,688**	1,359	+24.2	**43.4**	38.3
Residential sector	**279**	264	+5.7	**7.2**	7.4
	3,890	3,548	+9.6	**100.0**	100.0

The increased weight from the Office sector towards turnover was mainly due to the new Lee Garden Three, which provided predominantly office space, together with higher positive rental reversion achieved by other office buildings in our portfolio.

Key Performance Indicators

The Group's turnover growth and occupancy rate are the key measurements used for assessment of our core leasing business performance. Cost effectiveness is assessed by the Group's management using the property expenses ratio (as a percentage of turnover).

		Business Performance		
Key Performance Indicators	Definition	Portfolio	**2018**	2017
Turnover Growth	Rental revenue in current year vs that in last year	Retail Office Residential	**–** **+24.2%** **+5.7%**	-2.2% +5.2% -3.6%
Occupancy Rate	Percentage of total lettable area leased / total lettable area of each portfolio at year end	Retail* Office* Residential	**98%** **97%** **88%**	97% 96% 75%
Property Expenses Ratio	Property expenses divided by turnover	N/A	**13.4%**	12.7%

* 2017 percentages did not include Lee Garden Three, the redevelopment of which was completed in December 2017.

Note: Except for the occupancy rate mentioned above, no changes have been made to the source data or calculation methods used when compared to 2017.

Retail Portfolio

The Group's retail portfolio turnover was on par with last year at HK$1,923 million (2017: HK$1,925 million). There was good contribution from turnover rent of HK$81 million (2017: HK$48 million). The overall rental reversion in renewals, rent review and new lettings was largely neutral reflecting satisfactory positive reversions mixed with the impact from targeted tenant repositioning. The portfolio's occupancy, including the new Lee Garden Three's retail portion, was 98%, as at 31 December 2018 (31 December 2017: 97%, excluding Lee Garden Three).

Foot traffic in Hysan's retail portfolio saw an increase of around 11% in 2018, as compared to full year 2017. There was also a general improvement in the estimated overall tenant sales within the portfolio. Estimated tenant sales increased by around 16.2% as compared to 2017, outperforming Hong Kong's year-on-year retail sales growth of 8.8%.

Lee Garden Three held its official opening in November 2018. The event was attended by hundreds of well-wishers as well as members of the media, and was Hysan's stand-out event of the year. Lee Garden Three is well known for its lifestyle shops such as HOMELESS, Tavolo Kids Living, BoConcept, KitchenAid and Stressless, plus hair stylist M Plus. The building's food and beverage outlets have also become some of the most popular dining destinations in town, with Belgos, John Anthony, Starbucks flagship store, Next Door Café and Bar, NOC Coffee, Reserva Ibérica Tapas Bar & Café, Sweet Fashion House and Zentro East offering a wide variety of food and drinks. A Happy Pancake, renowned for its long lines of customers, rounds off the list.

The new building's opening was a good opportunity for us to further energise the rest of the portfolio. 2018 saw a significant improvement in our "content" provision. Initiatives included an enhanced tenant mix, strong tenant and third-party partnerships, unique experiences and events, key branding programmes, improved and expanded loyalty programmes, and the start of a digital transformation.

New tenants included the family members' club Maggie & Rose, a strong addition to our children-focused Lee Garden Two. The Spa by Valmont and Sake Diamond added new lifestyle experiences to the portfolio, while Hysan Place welcomed a number of new or expanded sportswear tenants. In addition to our new food venues in Lee Garden Three, we also welcomed destination restaurants like 10 Shanghai and Ta-ke in Lee Garden Two, the popular experiential Haidilao in Lee Theatre Plaza, and a number of more casual eateries in Hysan Place.

We believe in maintaining strong relationships with our tenants after they move in. In 2018, almost a dozen partnership events were held with tenants and third parties, thereby bringing more attention to the area, generating business for tenants, and providing unique experiences to high-end shoppers. Brunello Cucinelli, BVLGARI, CHANEL BEAUTÉ, Dior, Lancôme, Louis Vuitton, Roger Vivier, rue Madame, The Spa by Valmont and TORY BURCH were among the tenants that hosted exclusive and glamorous events in partnership with Hysan.

We also generated considerable excitement for our general shoppers in the malls. Chinese New Year, Valentine's Day, Mother's Day and a Go Green restaurant campaign saw us hosting popular activities backed by strong promotions. The second half of the year also saw further campaigns for Mid-Autumn Festival with Maxim's, and Christmas and New Year with eslite bookstore. These campaigns combined great shopping or dining opportunities with special experiences.

We are building Lee Gardens' reputation as a venue for quality children's entertainment to attract more family traffic. Absolutely Fabulous Children's Theatre's monthly performances, the Hong Kong International Young Readers' Festival, and the reading of Gruffalo by Kidsfest were among the highlights of the year. There was also a Royal Kids Etiquette series of classes for younger children. More activities for children are planned for 2019.

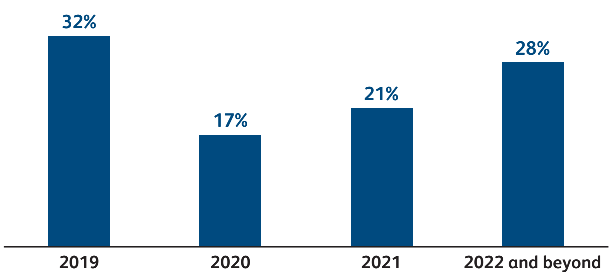
During 2018, we also took our events outdoors. In the first half of the year, the popular Cathay Pacific/HSBC Rugby Sevens Festival at Lee Gardens and its partner Lee Gardens Egglette Festival attracted the most attention. The remaining months began with Hong Kong Ballet's Alice (in Wonderland) street performances, as well as the November Standard Chartered Art Fun in Causeway Bay Night Parade. LOVE is NEARBY Christmas Community Festival, where top band Supper Moment and other singers performed at a popular street fair outside Lee Garden One, rounded off the year.

Running alongside more than a hundred of these events and activities were signature key branding programmes, supported by shopper promotion campaigns. Leeisure, Shopaholic, DeLeecious, and Athleeisure were all launched to attract more footfall and spending for different retail segments. In addition, strong efforts were made in both media and social media to drive awareness of Lee Gardens among Mainland Chinese and other tourists. A new and comprehensive tourist booklet was launched, while a VIP membership card for tourists, the Purple Card, was unveiled during the year. Moreover, we reinforced our partnerships with Hong Kong Tourism Board and leading local hotels to further promote our messages.

In regard to our loyalty programmes, Club Avenue for VIPs and Lee Gardens Plus for general shoppers, saw a substantial growth in their membership in 2018, as compared to 2017. Sales attributable to Club Avenue members experienced double-digit percentage growth. We are encouraged by the growth of these and will further invest in the hardware and software of our programmes to benefit all members.

On the technology front, the area-wide high-speed Wi-Fi system was successfully launched. The paperless e-coupon system was also unveiled and was well supported from the outset by a majority of shop tenants. We made substantial inroads into the enhancement of data collection from all touchpoints, with enhanced data privacy protection. In addition, an integrated customer relationship management system is about to be launched. More than 100 digital signs are now under a central control point, while more interactive e-directories have been added. The use of big data, analytics, prediction and artificial intelligence will be key to the future of the retail sector. Hysan is committed to making the best use of available technology to gain better insight and to add value to all our retail tenants.

Retail Lease Expiry Profile by Area Occupied (As at 31 December 2018)



Growing a community and curating its content require committed buy-in from those who do business in the neighbourhood. Lee Gardens Association has taken on the role of enlivening the area through street events, activities and social media promotions. Many of the area's main events, like the Rugby Sevens Festival, Egglette Festival and Night Parade were spearheaded by the Association. New Association members include several traditional businesses that have operated in the area for decades, and which have taken part in a number of the Association's social media drives. We are heartened that many of the neighbourhood's property owners have expressed interest in the creative business concepts introduced by the Association. Hysan looks forward to more cooperation with the Association to further enhance the area as a popular destination for all.

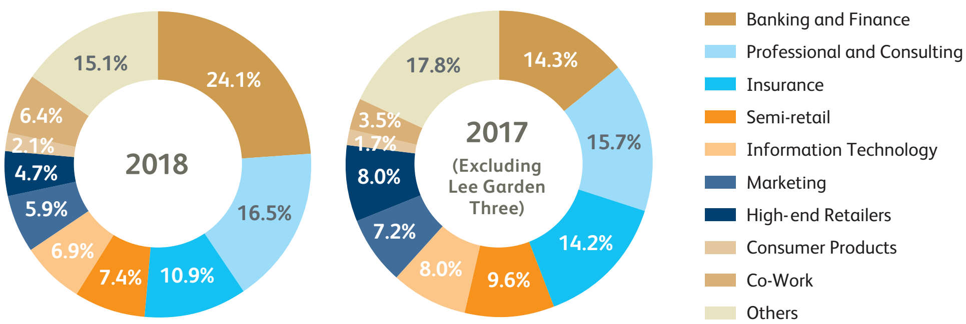
Office Portfolio

The Group's office portfolio turnover increased by 24.2% to HK$1,688 million (2017: HK$1,359 million). This performance reflected contributions from the newly completed Lee Garden Three, as well as overall robust positive rental reversion on renewals, rent review and new lettings. The office portfolio occupancy was 97%, as at 31 December 2018, including occupancy of the new Lee Garden Three (31 December 2017: 96%, excluding Lee Garden Three).

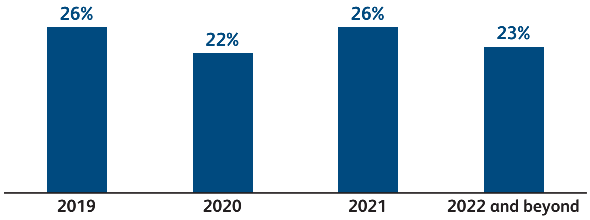
Tenants demand the highest standards of both building hardware and building service software. Lee Garden Three offers many green and wellness features, including a Hong Kong-first commercial building running track, together with a popular retail podium of restaurants and lifestyle shops. All these amenities are further supplemented by the area's eclectic mix of commercial and social offerings plus ample convenient parking facilities. Lee Gardens has become an established and viable choice for multinational and local firms.

We have maintained a diverse tenant mix over the years. With the completion of Lee Garden Three, which has attracted a number of Banking and Finance tenants, this sector has increased to about 24% and has now overtaken Professional and Consulting as the largest sector area-wise in our office portfolio. Banking and Finance, together with the next three top sectors, including Professional and Consulting, Insurance and Semi-Retail, take up around 59% of our office lettable floor area (2017: 54%).

Office Tenant Profile by Area Occupied as at Year-end



Office Lease Expiry Profile by Area Occupied (As at 31 December 2018)



Residential Portfolio

Hysan's residential portfolio, comprising mainly the units in Kennedy Road's Bamboo Grove, recorded a 5.7% growth in turnover to HK$279 million (2017: HK$264 million). The residential sector's occupancy improved to 88% (31 December 2017: 75%). The units previously under renovation are now available and have proven to be popular. We continue to make improvements to Bamboo Grove to attract prospective tenants. A small urban farm, for example, is being planned for Bamboo Grove to enhance the community spirit.

The rental reversion was overall positive in renewals, rent review and new lettings.

Tai Po Luxury Residential Project

The design development of our low-density residential development project at Tai Po is making good progress. Various statutory submissions are ongoing. Site work has also commenced.

"My great, great grandfather worked as a chef for an American trading company where he learned how to cook western cuisine. Eventually, he branched out to open his own restaurants and moved across the border to Hong Kong. The design and interiors, much like certain items on the menu, have not changed since the restaurant first opened. If we change anything, it will no longer be 'Tai Ping Koon' for our customers. Some of them, including plenty of celebrities, have been coming here for generations."

Andrew Chui
Managing Director of
Tai Ping Koon

Financial Review

A review of the Group's results and operations is featured in the preceding sections. This section deals with other significant financial matters.

Operating Costs

The Group's operating costs are generally classified as property expenses (direct costs and front-line staff wages and benefits) and administrative expenses (indirect costs largely representing payroll related costs of management and head office staff).

Property expenses increased by 16.5% to HK$523 million (2017: HK$449 million), reflecting the commencement of operation of Lee Garden Three during the year. The property expenses to turnover ratio thus increased slightly from 12.7% to 13.4% as compared to 2017. Administrative expenses decreased by 8.1% to HK$227 million (2017: HK$247 million).

Finance Costs

Finance costs amounted to HK$222 million in 2018, an increase of 40.5% from HK$158 million in 2017, mainly due to (i) cessation of interest expense capitalisation of HK$51 million upon Lee Garden Three's completion in 2017; and (ii) interest rate increases in 2018, which impacted interest cost of our floating rate debts. If the capitalised interest expenses and related borrowing costs were expensed last year, the Group's finance costs in 2017 would have been HK$209 million. The finance costs of 2018 would then have increased by HK$13 million or 6.2%. The Group's average cost of finance in 2018 was 3.6%, a slight increase from 3.4% reported for 2017.

Further discussion of the Group's treasury policy, including debt and interest rate management, is set out in the "Treasury Policy" section.

Revaluation of Investment Properties

As at 31 December 2018, the Group's investment real estate portfolio was valued at HK$77,442 million, an increase of 6.9% from HK$72,470 million as at 31 December 2017. This valuation was carried out by Knight Frank, an independent professional valuer, on the basis of open market value. The capitalisation rates used in valuing each portfolio remained unchanged from those used as at 31 December 2017.

Fair value gain on investment properties (excluding capital expenditure spent on the Group's investment properties) of HK$3,532 million (2017: HK$853 million) was recognised in the Group's consolidated statement of profit or loss for the year. This figure reflected a combination of factors: a generally positive rental outlook across our portfolio and the completion of a number of asset enhancement works.

The following shows the property valuation of each portfolio at year-end.

	2018 HK$ million	2017 HK$ million	Change %
Retail	**35,102**	33,188	+5.8
Office	**34,159**	31,325	+9.0
Residential	**8,181**	7,957	+2.8
	77,442	72,470	+6.9

Investment in Associates and a Joint Venture

The Group's investment in associates mainly represents interests in Shanghai Grand Gateway in Shanghai, China. The share of results of associates increased to HK$288 million (2017: HK$220 million). As at 31 December 2018, properties at Shanghai Grand Gateway had been revalued at fair value by an independent professional valuer. The Group's share of the revaluation gain, net of the corresponding deferred tax thereon, amounted to HK$96 million (2017: HK$11 million).

The Group's investment in a joint venture represents interests in a Tai Po residential project. The increase in carrying value represents costs incurred by the project.

Other Investments

In addition to placing surplus funds as time deposits in banks with strong credit ratings, the Group also invested in investment grade debt securities.

Excluding recognition of imputed interest income on interest-free loan to a joint venture company for a residential site development in Tai Po of HK$29 million (2017: HK$28 million), like-for-like interest income increased by 19.5% to HK$49 million (2017: HK$41 million). This figure mainly reflected higher interest rates from deposits.

During 2018, the Group invested in a real estate fund covering certain properties in Hong Kong and other major cities in Asia, with a view to expanding our reach in collaboration with professional property managers and to generate a new source of income and capital.

Cash Flow

Cash flow of the Group during the year is summarised below. Cash include liquid cash and bank deposits with less than 3 months' tenor.

	2018 HK$ million	2017 HK$ million	Change %
Cash generated from operations	**3,224**	2,900	+11.2
Net (advance to) repayment from a joint venture company	**(56)**	935	n/m
Net borrowing (repayment)	**46**	(130)	n/m
Interest and taxation	**(636)**	(587)	+8.3
Dividends paid and proceeds on exercise of options	**(1,551)**	(1,524)	+1.8
Capital expenditure	**(1,203)**	(1,947)	-38.2
Other investments	**211**	1,020	-79.3
Net cash inflow	**35**	667	-94.8

n/m: not meaningful

The Group's net cash generated from operations was HK$3,224 million (2017: HK$2,900 million), HK$324 million higher than in 2017, reflecting the growth of our core leasing business.

Net advance to a joint venture company of HK$56 million was for a residential site development in Tai Po. In 2017, net repayment from a joint venture company was HK$935 million after the completion of project financing on land acquisition costs.

Net borrowing was HK$46 million, reflecting net borrowing of fixed rate notes of HK$150 million, and repayment to non-controlling interest of a subsidiary during the year. In 2017, net repayment was HK$151 million during the year.

Cash from other investments was HK$211 million (2017: HK$1,020 million), mainly attributable to reduction in deposits with longer tenor.

The Group paid dividends of HK$1,444 million (2017: HK$1,411 million), being the 2017 second interim dividend of HK111 cents per share (2017: HK109 cents) and the 2018 first interim dividend of HK27 cents per share (2017: HK26 cents).

Capital Expenditure and Management

The Group is committed to enhancing the asset value of our investment property portfolio through selective asset enhancement and redevelopment. The Group has also established a portfolio-wide whole-life cycle maintenance programme as part of our ongoing strategy to pro-actively implement preventive maintenance activities. Total cash outlay of capital expenditure during the year was HK$1,203 million (2017: HK$1,947 million), including the payment of the construction costs of Lee Garden Three.

Treasury Policy

Market Highlights

The global economy performed strongly at the beginning of 2018. However, as sentiment soured amid growing China-U.S. trade tensions, the Hong Kong stock market tumbled more than 20% from its peak in January and global financial markets became more volatile. In view of the 10-year lowest unemployment rate and relatively low inflation rate, the U.S. Federal Reserve raised the federal fund rate by four hikes, amounting to a total of 100 basis points in 2018. With the expectation of market volatility and slowing global economic growth, the Federal Reserve lowered its forecast for interest rate hikes in 2019. Under the currency board system, Hong Kong Monetary Authority also raised its base rate in line with the federal funds rate by 100 basis points during 2018. The Hong Kong dollar (HKD) HIBOR rate also rose sharply during 2018, narrowing the differential with the U.S. dollar LIBOR rate. The 3-month HKD HIBOR increased from around 1.3% at the end of 2017 to around 2.3% at the end of 2018. Despite the increase in HIBOR, the Hong Kong bank loans market continued to be liquid. The credit margin of bank loans for companies with investment grade credit ratings saw a modest decline.

Despite the slow-down in the global economy and uncertainties in the macro environment, the Hong Kong economy is fundamentally in good shape and the unemployment rate at 2.8% is the lowest since 1998. The completion of two mega infrastructure projects, namely the Hong Kong-Zhuhai-Macau Bridge and the Express Rail Link, is set to further increase the number of inbound tourist arrivals from Mainland China. A rise in domestic household spending may further benefit Hong Kong's economy. However, the Hong Kong economy also saw some signs of slowing down when GDP growth in Q3 and Q4 retreated to 2.8% and 1.3% respectively, when compared to 4.1% in the first half of the year.

Uncertainties in global political issues and financial markets may worsen our operating environment as well as dampen expansion. It is therefore important for the Group to continue with our prudent financial management policy.

Capital Structure Management

To ensure a healthy financial position and a suitable capital structure servicing the Group's finance needs and sustainable growth, the Group always strives to diversify its funding sources, maintain a suitable debt maturity profile relative to the overall use of funds, maintain adequate liquidity, keep a low borrowing margin relative to market conditions, and adopt suitable hedging and forex management strategies.

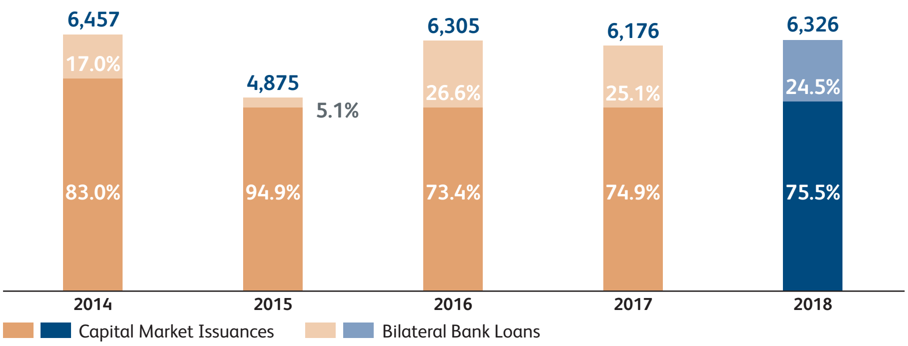
Funding Source

During the year, the Group issued and repaid medium-term notes of HK$300 million and HK$150 million respectively. The Group's outstanding gross debt[1] was HK$6,326 million (2017: HK$6,176 million) at year-end 2018. All the outstanding borrowings are on an unsecured basis.

At the end of 2018, the proportion of debts sourced from the capital market increased slightly to 75.5% (2017: 74.9%). The Group continued to maintain long-term relationships with a number of local and overseas banks to diversify its funding sources. At year-end of 2018, eight local and overseas banks provided bilateral banking facilities to the Group as funding alternatives.

The following graph shows the percentages of total outstanding gross debts sourced from banks and the debt capital markets over the past five years.

Sources of Financing at Year-end (HK$ milion)



The Group also strives to maintain an appropriate debt maturity profile to match with the nature of our assets and operations. As at 31 December 2018, the average maturity of the debt portfolio was about 3.9 years (2017: 4.3 years), of which about HK$300 million or 4.7% of the outstanding gross debt will be due in 2019. Given our strong cash balance, debt repayment will not cast much immediate refinancing pressure.

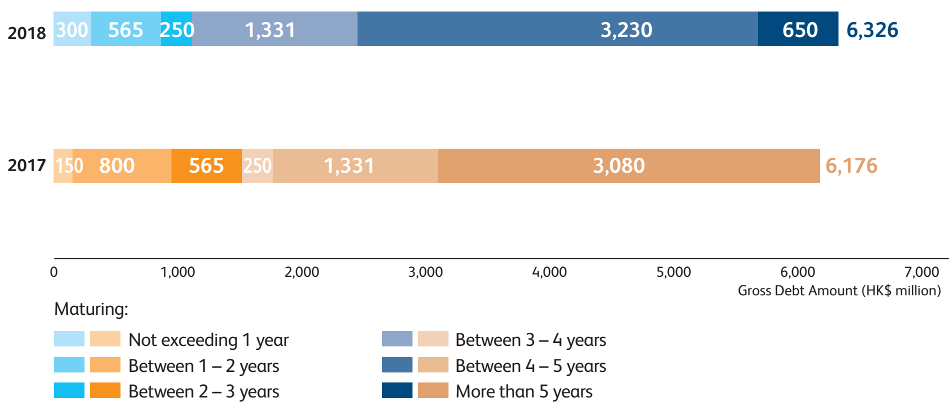
To further diversify our source of funding into investors who highly regard businesses with green initiatives, the Group has established its Green Finance Framework in late 2018, leveraging our sustainable building development and operations with green initiatives. The framework supports both green bonds and green loans enabling a choice of flexibility in the Group's future financing. After the reporting period, the Group has raised its first green bond of HK$300 million at a coupon rate of 3.33% due in 2026.

1 The gross debt represented the contractual principal payment obligations as at 31 December 2018. However, in accordance with the Group's accounting policies, the debt was measured at amortised costs, using the effective interest method. As disclosed in the consolidated statement of financial position as at 31 December 2018, the book value of the outstanding debt of the Group was HK$6,322 million (31 December 2017: HK$6,185 million).

Maturity Profile

The graph below shows the debt maturity profile of the Group at year-end 2018 and 2017.

Debt Maturity Profile at 2018 and 2017 Year-end

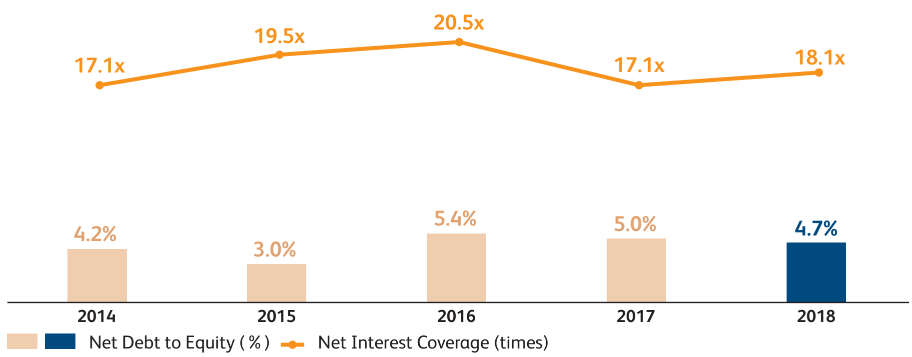


Gearing Ratio and Net Interest Coverage

The Group's gearing ratio, as measured by Net Debt to Equity ratio[1], decreased slightly from 5.0% at year-end of 2017 to 4.7% at year-end of 2018, because of the increase in equity from HK$70 billion at year-end of 2017 to HK$74 billion at year-end of 2018 driven by the increase in fair value of investment properties. The Group's Net Interest Coverage[2] increased to 18.1 times for 2018 (2017: 17.1 times) due to the improved operating results. The low gearing and strong ability to meet interest payments reflected the Group's resilience and capability to raise further debt for new investments and projects, if necessary.

The graph below shows the level of leverage and our ability to meet interest payment obligations over the past five years.

Net Debt to Equity and Net Interest Coverage at Year-end



1 Net Debt to Equity is defined as borrowings less time deposits, cash and cash equivalents divided by shareholders' funds.
2 Net Interest Coverage is defined as gross profit less administrative expense before depreciation divided by net interest expenses.

Credit Rating

The Group aims at maintaining investment-grade credit ratings to ensure a stable and lower cost of financing, and reflect our prudent financial management strategy. During the year, Fitch upgraded the Group's credit rating from BBB+ to A-, reflecting the Group's strong financial position.

	2018	2017
Moody's	**A3**	A3
Standard and Poor's	**BBB+**	BBB+
Fitch	**A-**	BBB+

Liquidity Management

As at 31 December 2018, the Group had cash and bank deposits totalling about HK$2,817 million (2017: HK$2,662 million). In order to preserve liquidity and enhance interest yields, the Group invested HK$227 million (2017: HK$737 million) in debt securities.

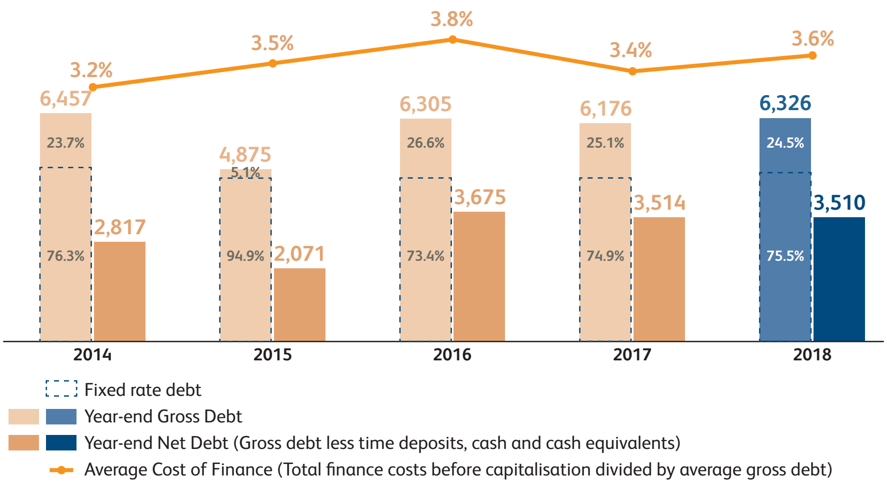
Further liquidity, if needed, is available from the undrawn committed facilities offered by the Group's relationship banks. These facilities, amounted to HK$950 million at year-end 2018 (2017: HK$950 million), essentially allowing the Group to obtain additional liquidity as the need arises.

Interest Rate Management

The fixed rate debt ratio increased slightly to 75.5% at year-end 2018 from 74.9% at year-end 2017. 2018 saw the start of interest rate normalisation cycle and it is expected that interest rate will continue to rise in 2019, although in a slower pace when compared to 2018. We believe we are in a good position to manage our finance costs given our fixed rate debt ratio.

The diagram below analyses the Group's debt level in term of gross and net debt, fixed and floating rates, together with average cost of finance over the past five years.

Debt Levels (HK$ million) and Average Cost of Finance (%)



Foreign Exchange Management

The Group aims to achieve minimal currency exposure and does not speculate in currency movements for asset and liability management. Except for US$300 million fixed rate notes, which have been hedged by an appropriate hedging instrument, all of the Group's borrowings were denominated in Hong Kong dollar. For the US$300 million fixed rate notes issued in January 2013, a hedge was entered effectively to convert the borrowing into Hong Kong dollar.

On the investment side, as at 31 December 2018, the Group's outstanding foreign currency balances in cash, time deposits, debt securities and a real estate fund amounted to US$88 million (2017: US$131 million), of which US$28 million (2017: US$70 million) was hedged by foreign exchange forward contracts.

Other foreign exchange exposure mainly relates to investments in the Shanghai project. These unhedged foreign exchange exposures amounted to the equivalent of HK$3,715 million (2017: HK$3,779 million) or 4.3% (2017: 4.6%) of total assets.

Use of Derivatives

As at 31 December 2018, outstanding derivatives were mainly related to the hedging of foreign exchange exposures. Strict internal guidelines have been established to ensure derivatives are used to manage volatilities or to adjust the appropriate risk profile of the Group's treasury assets and liabilities.

Counterparty Credit Risk

All the deposits are placed with banks with strong credit ratings and the counterparty risk is controlled via prescribed limits and is monitored on a regular basis.

Before entering into any hedging transaction, the Group will ensure that its counterparty possesses strong investment-grade ratings to control credit risk. As part of our risk management, a limit on maximum risk-adjusted credit exposure is assigned to each counterparty, which basically reflects the credit quality of the counterparty.

"We opened our shop first on Lan Fong Road in 1986, and then we moved to Lee Garden One in 2005, so we've had this shop for 32 years. We have seen Causeway Bay change over these years, and we have built up so many memories here. Our customers are used to us being here, so we've never left. We designed the shop ourselves, and we've kept it simple and minimalistic instead of following trends. We do everything from our heart. It's important to us that when our customers wear our clothes, they feel happy."

Rosanna Ma & Ben Leung
Zeta store owners