2

BUSINESS PERFORMANCE

Management's Discussion and Analysis

Strategy

Hysan strives to create value and provide stable and progressive return for our shareholders from our investment portfolio, which is predominantly located in Hong Kong's prime Causeway Bay district. We continue to maintain a strategic focus on our Lee Gardens portfolio while also seeking to complement our core business by tapping investment opportunities in Mainland China and the new economy.

Review of Operations

Hysan's investment property portfolio comprises three sectors – office, retail and residential – covering a total floor area of approximately 4.5 million square feet. As at 31 December 2021, office properties made up around 55% of the Group's investment portfolio by gross floor area, with retail properties accounting for approximately 30%. These properties are located in Lee Gardens, Causeway Bay. Around 15% of the Group's portfolio by gross floor area consists of residential properties, which are mainly apartments in Bamboo Grove, Mid-Levels.

Turnover and Underlying Profit decreased year-on-year by 2.7% and 2.8% respectively. COVID-19 continued to pressure the office sector. The retail sector started to recover as economic fundamentals and market sentiment improved. The residential segment declined mainly due to limited expatriate demand.

The Board of Directors has declared a second interim dividend of HK117 cents per share (2020: HK117 cents) which will be payable in cash.

	2021 HK$ million	2020 HK$ million	Change
Turnover	**3,608**	3,710	-2.7%
– Office	**1,728**	1,814	-4.7%
– Retail	**1,620**	1,600	+1.3%
– Residential	**260**	296	-12.2%
Recurring Underlying Profit	**2,330**	2,398	-2.8%
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The reconciliation of Recurring Underlying Profit, Underlying Profit and Reported Profit (Loss) is as follows:

	2021 HK$ million	2020 HK$ million
Reported profit (loss)	**1,383**	(2,547)
Change in fair value of properties	**493**	4,692
Investment properties	**720**	4,903
Less: Effect of other non-controlling interests	**(55)**	(223)
Share of associates (net of tax)	**(172)**	12
Imputed interest income on interest-free loan to a joint venture	**(13)**	(30)
Other gains and losses	**8**	(5)
Profit attributable to perpetual capital securities holders	**459**	288
Recurring Underlying Profit/Underlying Profit	**2,330**	2,398

Key Performance Indicators

The Group's turnover growth and occupancy rates are the key measurements used for the 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	Sector	2021	2020
Turnover Growth	Rental revenue in current year vs that in previous year	Office Retail Residential	**-4.7%** **+1.3%** **-12.2%**	-1.0 % -12.9 % -7.2 %
Occupancy Rate	Percentage of total lettable area leased / total lettable area of each portfolio at year-end	Office Retail Residential	**94%** **99%** **71%**	95 % 96 % 74 %
Property Expenses Ratio	Property expenses divided by turnover	N/A	**13.8%**	13.2 %

Note: No changes have been made to the source data or calculation methods used when compared to 2020.

Office

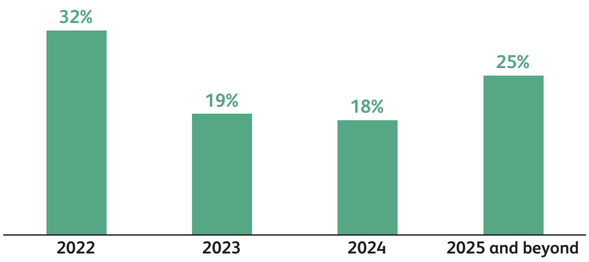
Turnover of the Group's office portfolio recorded a decline of 4.7% to HK$1,728 million (2020: HK$1,814 million), including turnover rent of HK$5 million (2020: HK$7 million).

Hong Kong's office rental market saw reduced demand and rental pressure during the period under review. The submarkets of Central and Wan Chai/Causeway Bay were among those most affected, due to major tenants' downsizing. However, several established flexible workspace operators took the opportunity to expand in popular commercial areas like Causeway Bay.

The average rental reversion rate on renewals, rent review and new lettings for Hysan's Lee Gardens portfolio slipped into negative territory, but occupancy held firm at a resilient 94% as at 31 December 2021 (2020: 95%).

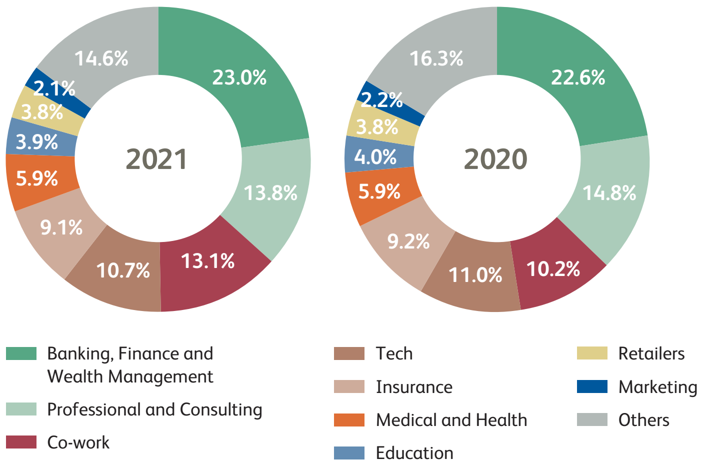
Hysan's offices are seen as ideal locations for the wealth management industry owing to their premier location, excellent facilities and complementary retail amenities. HSBC and Standard Chartered Bank each leased one of the upper floors in Hysan Place and Lee Garden One respectively. Given this combination of attractive location and office/retail synergies, we expect that our offices will remain attractive to technology firms, flexible workspace operators, and the medical and health sector.

Office Lease Expiry Profile by Area Occupied (As at 31 December 2021)



The office tenant profile remained stable. Banking, Finance and Wealth Management (23.0%), Professional & Consulting (13.8%) and Co-Work (13.1%) accounted for the top three slots in our tenant portfolio by floor area occupied, while the Tech sector was in fourth place with 10.7%.

Office Tenant Profile by Area Occupied as at Year-end



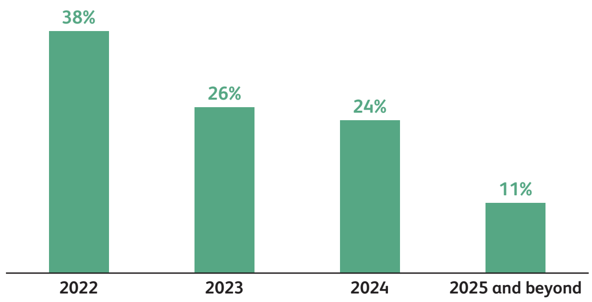
Retail

Turnover of the Group's retail portfolio experienced an increase of 1.3% to HK$1,620 million (2020: HK$1,600 million), including an increase in turnover rent to HK$112 million (2020: HK$44 million). Retail occupancy was 99% as at 31 December 2021 (2020: 96%). The average rental reversion rate on renewals, rent review and new lettings remained negative during the year.

Hong Kong retail sales generally improved throughout 2021 as the COVID-19 situation became less volatile, the employment market improved, and the government's consumption voucher scheme was rolled out. However, the lack of any meaningful cross-border traffic led to minimal tourist spending. The recovery of some retail sub-sectors still depends on the return of visitors from Mainland China and overseas.

Our own retail tenants' sales were also buoyed by these positive trends in the Hong Kong economy. With Hysan maintaining its traditionally strong relationship with local consumers, estimated tenant sales for the year outperformed overall Hong Kong retail sales. During 2021, our tenant list expanded to include a number of food and beverage outlets, luxury boutiques, lifestyle and apparel shops, and health and beauty product stores. We also hosted pop-up shops, including a popular art gallery.

Retail Lease Expiry Profile by Area Occupied (As at 31 December 2021)



Marketing Initiatives and Loyalty Programmes

In response to the official pandemic prevention measures in force throughout the year, Hysan rolled out a series of digital marketing campaigns to enable a 24/7 shopping experience. This included collaborations with luxury brands, as well as international and local labels. Our "Dine Safe at Lee Gardens" and "Power Up" campaigns also offered e-coupons and merchant e-vouchers from restaurant tenants and other renowned brands.

Beyond digital, our physical marketing campaigns also brought impressive traffic to Lee Gardens and drove strong sales. Our two major Christmas campaigns attracted more than 1.3 million visitors to the area over the promotional period. Crowd-pleasing shopping privileges saw a more than 15% year-on-year rise for tenant sales transactions, bringing more than 30% increase in year-on-year promotional sales during the Christmas period.

Club Avenue saw further recruitment of VIP members via external partnerships and brand cooperation. Prominent brand events were held with fashion, jewellery and beauty ones having the highest profile. Overall members' spending achieved a double-digit percentage year-on-year growth across all membership tiers, with contributions from existing and quality new members.

Harnessing Business Technology

In 2021, Hysan unveiled "hy!", a one-stop digital engagement platform with comprehensive e-commerce capabilities that aims to engage stakeholders and strengthen customer activation and retention. With the official launch set for early 2022, the Hysan community will soon enjoy upgraded online functions that allow members to access a wider variety of e-shopping products as well as to participate in community programmes.

Meanwhile, the foundation data integration of Hysan's data lake will also be completed in early 2022. This process will consolidate information from multiple sources including membership, coupon usage, e-commerce transactions, car parking and others.

Against the backdrop of rapid changes to the office environment brought about by the COVID-19 pandemic and other factors, Hysan also upgraded its back-end remote system to further improve the efficiency of its "work from home" arrangements.

Residential

Hysan's residential portfolio turnover decreased by 12.2% to HK$260 million (2020: HK$296 million). Occupancy stood at 71% as at 31 December 2021 (2020: 74%).

Average rental reversion in the sector was negative with regard to renewals, rent review and new lettings.

The luxury residential rental market remained under pressure due to the lack of professional expatriates arriving in Hong Kong. Flexible leases were offered to customers in 2021, providing those who required shorter-term stays in Bamboo Grove with more options. To secure new tenants, we made agency fees more attractive and adopted a tenant referral programme.

Core Expansion and Strategic Pillars

Hong Kong Investment Property – Caroline Hill Road Project

Hysan will develop a premium commercial building with community facilities at the Caroline Hill Road site that neighbours its existing Lee Gardens portfolio. This joint venture project with Chinachem Group is a strategic long-term investment that will enhance the significance of Lee Gardens as a key commercial destination.

Ground investigation works began in the fourth quarter of 2021 and foundation works are expected to commence in the third quarter of 2022, with the entire project scheduled to be completed in 2026. The new site will be linked to the rest of Lee Gardens via a weatherproof walking route.

Shanghai Investment Property – Commercial Complex in Jing'an District

Subsequent to the year-end, Hysan acquired a commercial complex that is strategically located in the heart of Shanghai's Jing'an district. The newly completed 24-storey building features approximately 50,000 square metres of ready-to-rent Grade A office space and 18,000 square metres of retail space. Hysan is now conducting asset enhancement works for the retail space, with completion expected by mid-2023.

This investment marks an important step in Hysan's long-term planning and development strategy for Shanghai, through which we aim to bring our Lee Gardens business philosophy and smart community business model to China's most populous city.

Shanghai Investment Property – Grand Gateway 66

This investment property, in which Hysan owns a 26% stake, continued to record strong performance thanks to an asset enhancement initiative completed in 2020.

Residential Development – Tai Po Luxury Residential Project

Located on a verdant hilltop in Tai Po, Hysan's joint-venture residential development was ready for its sales launch in the first half of 2022. The low-density project comprises 262 exclusive houses and flats, showcasing Hysan's continuous pursuit of excellence in design and facilities.

Its geographical advantages will be amplified by the future development of Hong Kong's "Northern Metropolis", complementing the already-burgeoning Shenzhen business districts just across the border. When completed, the Tai Po site will become the perfect haven for executives and professionals working in those areas.

Residential Development – URA Residential Project in To Kwa Wan

In February 2022, Hysan acquired a 25% stake in a joint venture with Henderson Land and Empire Holdings to develop the URA residential project at Bailey Street/Wing Kwong Street in To Kwa Wan.

This is a quality site with high development potential, adjacent to the burgeoning commercial and residential hub of Kai Tak and within 5-minute walking distance to To Kwa Wan and Sung Wong Toi MTR stations. Hysan will leverage its skillsets by overseeing the design and operation of the retail portion of the project, which comprises a retail mall and shopping streets.

Greater Bay Area Flex – Joint Venture with IWG

In August 2021, Hysan and IWG plc formed a joint venture with the exclusive rights to operate all IWG brands in Hong Kong and the Greater Bay Area. The investment expands Hysan's business footprint in the Greater Bay Area into flexible workspace. The joint venture operates 33 existing locations across the Greater Bay Area and will continue to expand the business presence of IWG's brands within the region's vast and growing flexible workspace market.

Hysan's vision encompasses a fast-evolving workspace ecosystem, with IWG playing an important role in meeting end-users' needs and expectations. The joint venture also reflects the confidence of both partners in the economic growth potential of the Greater Bay Area.

Medical and Health – New Frontier Group

New Frontier Group is a leading private healthcare services provider based in China which operates a system of acute hospitals, online hospital, rehabilitation and geriatric hospitals, oncology centres, ambulatory centres, outpatient clinics, home health network, doctor groups, training centres and health insurance services across China.

Hysan's minority stake investment in New Frontier Group provides strategic exposure for the Group in Mainland China's fast-growing healthcare sector and demand for premium healthcare services.

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 comprising payroll related costs of management and head office staff).

The Group's operating costs to turnover ratio was 21.4% (2020: 20.4%).

Finance Costs

Finance costs decreased to HK$393 million, as compared with HK$546 million in 2020, as the Group capitalized the interest expense of funds used to finance its property development activities. The Group raised approximately HK$7 billion from new issuance via its medium term note programme in 2020, taking advantage of ample market liquidity and a low interest rate environment. During 2021, finance costs related to such funding exercises amounted to HK$394 million (2020: HK$313 million). The effective interest rate for the year was 2.9%, as compared with 3.0% in 2020.

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

Revaluation of Investment Properties

As at 31 December 2021, the Group's investment real estate portfolio was valued at HK$95,107 million, an increase of 26.8% from the HK$74,993 million recorded at the prior year-end, mainly due to the successful tender of a commercial site at Caroline Hill Road, Causeway Bay, Hong Kong in May 2021 at a land premium of $19,778 million.

The valuation was carried out by Knight Frank Petty Limited, an independent professional valuer, on the basis of market value. A fair value loss on investment properties (after considering capital expenditure spent on the Group's investment properties) of HK$720 million (2020: fair value loss of HK$4,903 million) was recognized in the Group's consolidated statement of profit or loss for the year. The loss mainly reflects heightened market risk in a challenged retail sector, coupled with an office sector weakened by continued global economic uncertainty.

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

	2021 HK$ million	2020 HK$ million	Change
Office	**34,707**	34,593	+0.3%
Retail	**31,868**	31,670	+0.6%
Residential	**8,712**	8,730	-0.2%
Property under development	**19,820**	–	n/m
	95,107	74,993	+26.8%

n/m: not meaningful

Investments in Associates and Joint Ventures

The Group's investments in associates are primarily represented by its interest in Grand Gateway 66, a retail, office and residential complex in Shanghai, China. The share of results of associates increased to HK$458 million (2020: HK$225 million), mainly due to the Group's share of the revaluation gain (net of deferred tax) amounting to HK$172 million (2020: revaluation loss of HK$12 million). The properties at Grand Gateway 66 were revalued at fair value by an independent professional valuer for both years ended 31 December 2020 and 2021.

The Group's investment in joint ventures comprises interests in a Tai Po residential project and in the IWG Flex business. The increase in carrying value reflects the acquisition of IWG Flex business completed in September 2021.

Other Financial Investments

During the year, the Group extended its geographical and business reach through certain strategic minority stake investments. Investment in New Frontier Group was one of the key initiatives which provides strategic exposure for the Group in the fast-growing healthcare sector in Mainland China. As at 31 December 2021, other financial investments totalled HK$1,780 million (2020: HK$789 million).

Bank Deposits

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 imputed interest income recognized on an interest-free loan of HK$13 million (2020: HK$30 million) to a joint venture company for a residential site development in Tai Po, like-for-like interest income decreased to HK$79 million (2020: HK$242 million) resulting from shorter-tenor bank deposits placed to provide flexibility to meet funding requirement from investment opportunities and other strategic initiatives.

Cash Flow

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

	2021 HK$ million	2020 HK$ million
Cash generated from operations	**2,845**	2,758
Net investment and advance to joint ventures and other financial investments	**(1,126)**	(285)
Net borrowings	**7,507**	6,458
Issuance of perpetual capital securities, net of distribution and transaction costs	**(459)**	10,314
Bank deposits	**8,340**	(4,843)
Interest and taxation	**(861)**	(980)
Dividends paid	**(1,617)**	(1,621)
Considerations for share repurchases	**(146)**	(96)
Capital expenditure	**(22,334)**	(913)
Net cash (outflow) inflow	**(7,851)**	10,792

The Group's cash generated from operations was HK$2,845 million (2020: HK$2,758 million), HK$87 million higher than that in 2020, reflecting improvement in working capital management.

Net investment and advance to joint venture and other financial investments, amounted to HK$1,126 million (2020: HK$285 million) in 2021 related to the investment in IWG Flex business, an advance to the residential site development in Tai Po and investment in New Frontier Group.

Net borrowings amounted to HK$7,507 million, reflecting an advance from non-controlling interest, issuance of fixed rate notes and repayment of bank loans. In 2020, total net borrowings were HK$6,458 million.

In 2020, the Group through a wholly owned subsidiary of the Company (the "Issuer") issued US$850 million (equivalent to approximately HK$6,604 million) 4.10% subordinated perpetual capital securities, which are unconditionally and irrevocably guaranteed by the Company. Further, the Issuer issued US$500 million (equivalent to approximately HK$3,875 million) 4.85% senior perpetual capital securities, which are unconditionally and irrevocably guaranteed by the Company. The proceeds of the capital securities are for general corporate purposes and the capital securities are listed on The Stock Exchange of Hong Kong Limited. In 2021, the distribution paid to perpetual capital securities holders amounted to HK$459 million.

Cash from bank deposits was HK$8,340 million (2020: cash placed in bank deposits: HK$4,843 million), which was mainly attributable to increase in shorter tenor deposits.

The Group paid dividends of HK$1,497 million (2020: HK$1,502 million), via a 2020 second interim dividend of HK117 cents per share (2020: HK117 cents) and a 2021 first interim dividend of HK27 cents per share (2020: HK27 cents).

During the year, the Group repurchased 5.5 million of its own shares as part of its capital management programme for an aggregate consideration of approximately HK$146 million.

Capital Expenditure and Management

The Group had successfully tendered for the Caroline Hill Road commercial site in May 2021 for a consideration of HK$19,778 million to develop a premium commercial project. In addition to this strategic development project, the Group is also committed to enhancing the asset value of its current 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 proactively implement preventive maintenance activities.

Total capital expenditure during the year was HK$22,334 million (2020: HK$913 million).

Treasury Policy

Capital Structure Management

To ensure a healthy financial position and a suitable capital structure servicing its financing needs and achieving sustainable growth, the Group constantly strives to diversify its funding sources and maintain an appropriate debt maturity profile relative to the overall use of funds. It also aims to maintain adequate liquidity, keep a low borrowing margin relative to market conditions, and adopt suitable hedging and forex management strategies.

Funding Sources

The Group's total Gross Debt[1] level decreased to HK$18,807 million as at 31 December 2021 (2020: HK$19,204 million), mainly owing to new issuance of HK$400 million of medium-term notes and early repayment of HK$800 million in bank loans during the year.

As at 31 December 2021, bank loans accounted for approximately 8% of the Group's total Gross Debt with the remaining 92% made up of capital market financing (2020: 11% : 89%). All the Group's debts are on an unsecured and committed basis.

The following table shows the Group's sources of debt financing as at 31 December 2021:

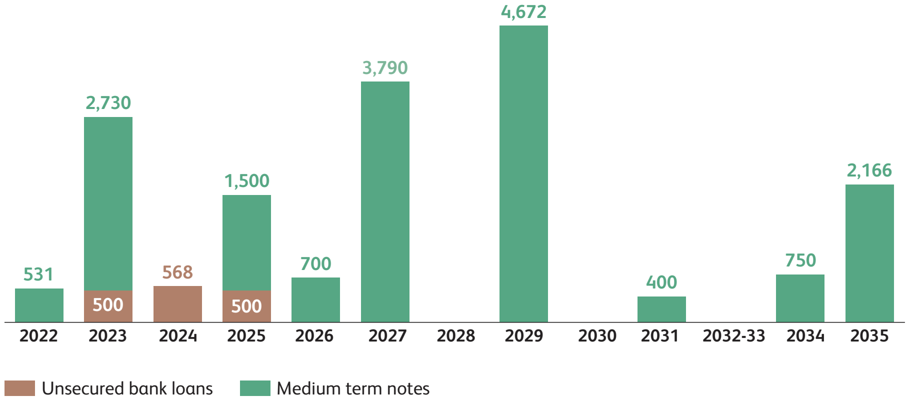
	Available HK$ million	Drawn HK$ million	Undrawn HK$ million
Term loans	1,817	1,567	250
Committed revolving loans	5,300	–	5,300
Capital market issuances	17,240	17,240	–
Total committed facilities	**24,357**	**18,807**	**5,550**
Uncommitted revolving loans	1,580	–	1,580
Total source of debts financing	**25,937**	**18,807**	**7,130**

Maturity Profile

The Group maintains a well-structured debt maturity profile extending over in the next 14 years, aligned appropriately with the nature of our assets and operations. As at 31 December 2021, the average maturity of debt portfolio was about 6.1 years (2020: 6.8 years). The Group has approximately HK$531 million of debt maturing in 2022.

1 Gross Debt represents the Group's contractual principal payment obligations as at 31 December 2021. However, in accordance with the Group's accounting policies, the debt is measured at amortized costs, using the effective interest method. As disclosed in the Group's consolidated statement of financial position as at 31 December 2021, the book value of the outstanding debt of the Group was HK$18,657 million (2020: HK$18,970 million).

Debt Maturity Profile at the end of 2021 (HK$ million)



Gearing ratio and net interest coverage

The Group's gearing ratio, as measured by Net Debt to Equity ratio[2], was 11.7% at year-end 2021 (2020: net cash position). The Group's Net Interest Coverage decreased to 9.1 times for 2021 (2020: 9.8 times).

Credit Rating

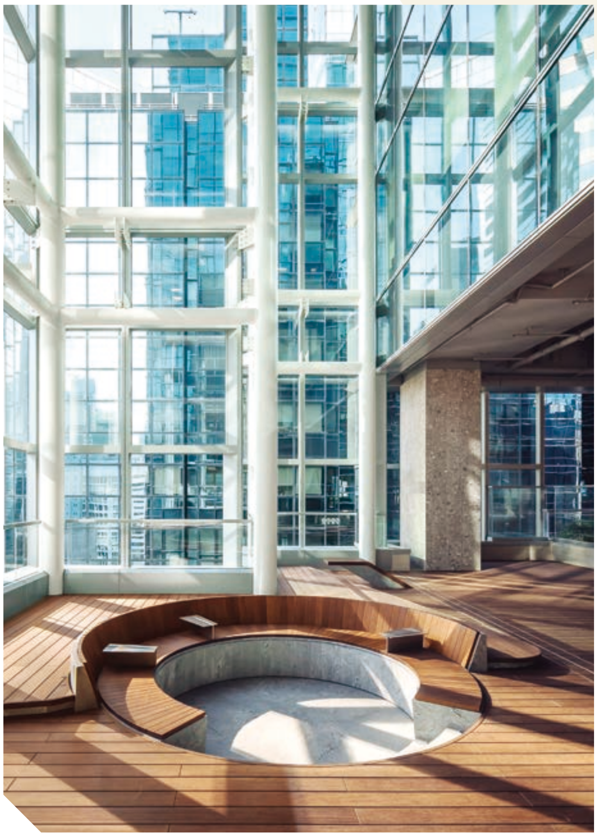
The Group aims to maintain investment-grade credit ratings and keeps up active dialogue with credit rating agencies. As at 31 December 2021, the Group maintained its credit ratings at A3 from Moody's and A from Fitch, reflecting its strong financial position and prudent capital management strategy.

2 Net Debt to Equity ratio is defined as borrowings less time deposits, cash and cash equivalents divided by total equity.

Liquidity Management

As at 31 December 2021, the Group had cash and bank deposits totalling about HK$8,404 million (2020: HK$24,935 million). To preserve liquidity and enhance interest yields, the Group invested HK$1,014 million (2020: HK$454 million) in investment-grade 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$5,550 million as at the end of 2021 (2020: HK$5,450 million), allow the Group to obtain additional liquidity as the need arises.



Interest Rate Management

Interest expense represents one of the key costs of the Group's business. The Group monitors its interest rate exposure closely and adopts an appropriate hedging strategy in light of market conditions. The fixed rate debt ratio (after taking into account interest rate swap) as at 31 December 2021 was 75% (2020: 88%). The effective interest rate decreased slightly to 2.9% at the end of 2021 from 3.0% at the prior year-end.

Foreign Exchange Management

The Group aims to achieve minimal currency exposure and does not speculate in currency movements for asset and liability management purposes.

All USD fixed rate notes were hedged through cross-currency swaps that effectively converted the borrowings into HKD. A USD bank loan has also been drawn down as a natural hedge against the Group's outstanding foreign currency balances in debt securities investments.

Use of Derivatives

As at 31 December 2021, all the Group's outstanding derivatives were related to the hedging of foreign exchange exposures. Strict internal guidelines have been established to ensure derivatives are only used to manage volatilities or to adjust the risk profile of the Group's treasury assets and liabilities in an appropriate manner.

Counterparty Credit Risk

All deposits are placed with banks with strong credit ratings and counterparty risk is monitored on a regular basis.

Before entering into any hedging transaction, the Group ensures that its counterparties possess strong investment-grade ratings, so as 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.

Sustainable Finance Initiatives

The Group established its Green Finance Framework ("Framework") in 2019 and subsequently issued HK$1,550 million green bonds to refinance the construction costs for Lee Garden Three, which has achieved green building certificates from BEAM Plus and LEED. In July 2021, we established the Sustainable Finance Framework, expanding the scope of the Framework to finance eligible projects that potentially offer a positive environment and social impact.

Under the Framework, the Group has completed the following sustainable finance transactions:

- HK$1,550 million green bonds issued in 2019
- US$125 million sustainability-linked hedging solution in 2020
- HK$400 million sustainable bonds issued in 2021
- HK$965 million sustainability-linked loans in 2021

Total sustainable financing at year-end stood at approximately HK$3,890 million, representing around 21% of the Group's total Gross Debts. We aim to gradually increase the sustainable finance portion of the Group's overall debt portfolio.