MANAGEMENT DISCUSSION AND ANALYSIS

PRINCIPAL INVESTMENT

PRINCIPAL INVESTMENT

During the year, the Group recognized an operating profit generated from the Principal Investment (including dividend income) of HK$327 million, down 92% as compared to last year.

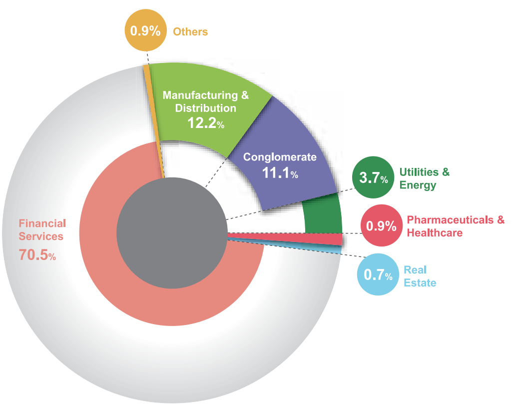
In the first half of the financial year, we crystallized profits from our investments in Japan and China. As the aging bull market inched forward, we believed that it would be wise to manage our exposure prudently. Our emphasis on dividend paying stocks provided stability to the value of our investments in the volatile second half of the year. The realised profit and the dividend income have mitigated the adverse mark-to-market fair valuation impact on our investment portfolio due to softening of the equity markets.

Our Treasury team performed well in optimizing the returns in foreign exchange and interest rate management for the Group. Foreign currency exposures with appropriate hedging netted good results in the year ended 30 June 2018. Through the deployment of yield enhancement strategies, our Treasury team generated a modest positive net interest income despite a larger loan liability in this financial year.

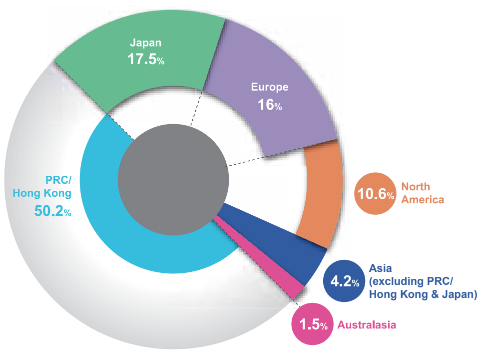
Investment Portfolio

As of 30 June 2018, the Group's total investments under the Principal Investment amounted to US$3,454 million. The investment portfolio consists of a total of over 40 securities. The breakdown of our investment portfolio (excluding The Bank of East Asia, Limited ("BEA")) as at 30 June 2018 by sector and geography are as follows:

By Sector:



By Geography:



Major Investment

Pursuant to substantial shareholding notification, the Group held approximately 14.15% in the total issued share capital of BEA. It is a major investment which accounted for more than 5% of the total asset value of the Group as at 30 June 2018 with a fair value of US$1,652 million, compared to US$1,712 million as at 30 June 2017. Dividend income received from the investment in BEA for the year amounted to approximately US$66 million.

For the first six months ended 30 June 2018, BEA earned a profit attributable to owners of the parent of HK$3,992 million, representing a decrease of HK$2,228 million or 35.8%, compared with the HK$6,220 million earned in the same period in 2017. The 2017 result included a net profit of HK$3,049 million from the disposal of discontinued operations, in respect of the disposal of Tricor Holdings Limited. Excluding the gain from discontinued operations recorded in the first half of 2017, profit attributable to owners of the parent increased by HK$821 million, or 25.9%, mainly contributed by higher net interest income and non-interest income, net fee and commission income and lower impairment.

It was set out in BEA's outlook that in the second half of 2018, BEA will focus on deepening the digital transformation process, expanding fee income, containing operating costs and enhancing asset quality. The bank will focus on raising non-interest income such as from retail/corporate wealth management and private banking services. BEA will continue to reduce its exposure to high-credit-risk and cyclical industries on the Mainland.

PROPERTY DEVELOPMENT AND INVESTMENT

Guoco Tower, Singapore

PROPERTY DEVELOPMENT AND INVESTMENT

GuocoLand Limited ("GuocoLand")

GuocoLand ended the financial year with revenue of S$1.16 billion and profit attributable to equity holders of S$381.3 million, an increase of 4% and 7% respectively as compared to the previous financial year.

Revenue in the current financial year was supported by stable contributions from GuocoLand's property development business, as well as higher contributions from the property investment business. Guoco Tower which was completed in October 2016 made its maiden full year contribution in this financial year. Meanwhile, gross profit increased by 11% to S$280.1 million as compared to the previous financial year.

Other income decreased by 48% to S$164.5 million as a result of lower fair value gain from Guoco Tower as compared to the previous financial year. Mainly due to higher sales activities and the commencement of the new hotels during the year, administrative expenses increased by 23% to S$90.6 million. Finance costs increased by 33% to S$96.2 million due to higher borrowings and lower capitalisation of finance costs as compared to the previous financial year.

Exterior view of DC Residensi, Malaysia (Artist's impression)

Contributions from Changfeng Residence, a joint venture residential project in Shanghai which has been substantially sold and completed, was the main reason for GuocoLand's share of profit of associates and joint ventures to increase by S$158.7 million to S$203.6 million.

According to statistics released by the Urban Redevelopment Authority in Singapore, private residential property prices increased by 3.4% for the second quarter of 2018. This was the fourth consecutive quarter of increase albeit lower than the 3.9% increase in the first quarter of 2018. On 5 July 2018, the government announced the latest round of property cooling measures, which includes higher Additional Buyer Stamp Duty rates and tighter Loan-to-Value limits on residential property purchases.

New home prices in Chongqing continued to be on the rise in July 2018. Official data showed that new home prices in Chongqing had increased 1.3% month-on-month and 8.2% year-on-year.

In Malaysia, GuocoLand will continue to focus on sales and leasing of its current projects amid challenging operating conditions which are expected to continue in the near term.

Exterior view of Changfeng Residence, Shanghai (Artist's impression)

HOSPITALITY AND LEISURE

Lobby of The Grovsenor Hotel, London

HOSPITALITY AND LEISURE

GL Limited ("GL")

GL recorded a profit after tax for the year ended 30 June 2018 at US$58.9 million, an increase of 20% as compared to US$48.9 million in the previous financial year.

Revenue decreased by 1% year-on-year to US$344.4 million due mainly to lower revenue generated by hotel and oil and gas segments. Hotel revenue was lower compared to last year as a result of fewer rooms available for sale due to the refurbishment of The Cumberland. However, the strengthening of GBP (increased by 6% year-on-year) against USD had mitigated the impact. Lower revenue from oil and gas segment compared to the previous financial year was due to lower oil and gas production despite an increase of 19% year-on-year in the average crude oil price. The increase in cost of sales was mainly due to the strengthening of GBP against USD.

River facing room of The Royal Horseguards Hotel, London

The increase in other operating income was due to compensation from the compulsory acquisition of one hotel property and a recovery of legacy loan which had been written off previously.

The increase in administrative expenses for the year was mainly due to the strengthening of GBP against USD. The decrease in other operating expenses was mainly due to one-off expenses in the previous financial year. These were the certain assets and equipment written off due to review of hotel business strategy and the settlement of a legal claim against a subsidiary in the United Kingdom which provided a guarantee to a third party in relation to a hotel property previously leased and operated by another subsidiary.

Wedding banquet at The Tower Hotel, London

Afternoon tea set at The Tower Hotel, London

Garden view of The Royal Horseguards Hotel, London

Higher financing costs for the year were due to higher interest cost from an interest rate hedging contract. Higher income tax expense was associated with higher earnings from the hotel segment.

The gaming segment had ceased operation on 29 March 2018. A non-recurring expense of US$6.3 million was incurred for redundancy costs, impairment loss on plant and equipment as well as the casino brand name during the year.

The refurbishment of The Cumberland is progressing into its final stage and the hotel is on track to be launched as the Hard Rock Hotel London in 2019. GL's total rooms available for sale will continue to be affected during this refurbishment period.

The Secret Herb Garden at the terrace of The Royal Horseguards Hotel, London

The Rank Group Plc ("Rank")

The FY2017/18 has been a challenging year for Rank driven principally by a disappointing performance from Grosvenor's casinos. Rank recorded a profit after tax (before exceptional items) for the year ended 30 June 2018 of GBP58.5 million, a decrease of 7.3% as compared to the previous year. Statutory revenue decreased by 2.3% to GBP691.0 million.

Revenue for Grosvenor Casinos declined by 6.1% in the year. Performance was materially impacted by further enhanced customer due diligence following the published advice of the UK Gambling Commission in September 2017. Consequently, customer visits declined resulting in revenue falling 9.9% in the second half compared to a 2.4% fall in the first half. Grosvenor's performance was further hindered by a lower gaming margin from its major players and adverse weather in the third quarter. Operating profit fell by 6.7% due to lower revenues.

Mecca's revenue fell 2.6% in the year driven by a 7.9% decline in customer visits. Operating profit fell by 4.3%, a lower decline than expected by management as a result of improved cost control across both employment and marketing activities. Mecca's new bingo concepts (Big Bingo Bash, Bonkers Bingo, Student events, Initial Newbie nights and other broader entertainment events) continued to be tested with good results. These concepts are helping drive visits as well as contributing incremental revenue and profit.

Rank's UK digital business grew with revenue up 9.9%. Importantly, a successful 'Meccarena' marketing campaign and ongoing investments into the meccabingo.com offer drove revenue up 10.9%, following two years of low single digit growth rates. Grosvenorcasinos.com grew revenue 8.2% in the year, however the more stringent customer due diligence (highlighted above) impacted the performance resulting in revenue declining in the second half following strong growth in the first half. Insufficient marketing investment and a temporary system issue, which resulted in some of our more valuable multi-channel customers not being contacted, exacerbated grosvenorcasinos.com's weak performance in the second half. Operating profit fell by GBP1.8 million in the year to GBP20.9 million following the introduction of remote gaming duty ('RGD') on customer bonuses, which resulted in GBP2.5 million of incremental RGD in the year.

The Spanish operations, Enracha, delivered a strong performance with revenue up 11.0% and operating profit up 2.8%.

Pretax exceptional items relating to continuing operations produced an exceptional cost of GBP26.9 million in the year, mainly comprising impairments of GBP12.1 million principally relating to the underperformance of five Grosvenor casinos and the experimental Luda venue, onerous lease costs of GBP9.1 million relating to leases of two operating casinos and a closed site as well as the closure costs of a Grosvenor's casino of GBP3.7 million.

FINANCIAL SERVICES

Headquarters of Hong Leong Bank Berhad, Kuala Lumpur

FINANCIAL SERVICES

Hong Leong Financial Group Berhad ("HLFG")

HLFG achieved a record profit before tax of RM3,578.6 million for the year ended 30 June 2018 as compared to RM3,089.9 million last year, an increase of RM488.7 million or 15.8%. The increase was mainly due to higher contribution from the commercial banking and insurance divisions.

The commercial banking division recorded a profit before tax of RM3,246.3 million for the year ended 30 June 2018 as compared to RM2,748.3 million last year, an increase of RM498.0 million or 18.1%. The increase was due to higher revenue of RM288.9 million, higher share of profit from Bank of Chengdu and Sichuan Jincheng Consumer Finance joint venture of RM172.6 million, higher write-back of impairment losses on financial investment of RM4.9 million and lower allowance for impairment losses on loans, advances and financing of RM84.5 million. This was however offset by higher operating expenses of RM52.9 million.

On 31 January 2018, Bank of Chengdu was officially listed on the Shanghai Stock Exchange after completing its initial public offering ("IPO") of 361 million shares and raised RMB2.53 billion. Arising from the IPO, the banking division's equity interest in Bank of Chengdu is now reduced from 20% to 18% of the enlarged capital.

The insurance division recorded a profit before tax of RM348.0 million for the year ended 30 June 2018 as compared to RM337.8 million last year, an increase of RM10.2 million or 3.0%. The increase was mainly due to higher revenue of RM24.7 million, lower operating expenses of RM1.4 million and higher life fund surplus of RM0.4 million. This was however offset by lower share of profit from associated company of RM10.3 million and higher allowance for impairment losses on securities of RM6.0 million.

The investment banking division recorded a profit before tax of RM78.6 million for the year ended 30 June 2018 as compared to RM84.0 million last year, a decrease of RM5.4 million or 6.4%. This was mainly due to lower contribution from the investment banking and stockbroking divisions.

GROUP FINANCIAL COMMENTARY

Financial Results

The audited consolidated profit attributable to equity shareholders for the year ended 30 June 2018, after taxation and non-controlling interests, amounted to HK$4,899 million, down 20% as compared to HK$6,124 million for the previous year. Basic earnings per share amounted to HK$15.07.

For the year ended 30 June 2018, profit before taxation was generated from the following sources:

- property development and investment of HK$6,247 million;
- hospitality and leisure of HK$1,073 million;
- financial services of HK$934 million;
- principal investment of HK$327 million;
- oil and gas royalty of HK$154 million;

and was offset by HK$834 million of finance costs.

Revenue increased by 119% to HK$30.6 billion, attributed by the increase in property development and investment sector of HK$15.8 billion.

Capital Management

The Group's consolidated total equity attributable to equity shareholders of the Company as at 30 June 2018 amounted to HK$65.5 billion, an increase of 6% or HK$3.6 billion as compared to the previous year.

The equity-debt ratio as at 30 June 2018 is arrived at as follows:

	HK$'M
Total borrowings	37,657
Less: Cash and short term funds	(19,860)
Trading financial assets	(13,016)
Net debt	4,781
Total equity attributable to equity shareholders of the Company	65,478
Equity-debt ratio	93 : 7

The Group's total cash balance and trading financial assets were mainly in USD (27%), RMB (22%), HKD (19%), SGD (10%), GBP (10%), and JPY (8%).

Total Borrowings

There was an increase in total borrowings from HK$37.2 billion as at 30 June 2017 to HK$37.7 billion as at 30 June 2018. The Group's total borrowings are mostly denominated in SGD (67%), USD (12%), GBP (7%) and MYR (6%).

The Group's bank loans and other borrowings are repayable as follows:

	Bank loans HK$'M	Mortgage debenture stock HK$'M	Other borrowings HK$'M	Total HK$'M
Within 1 year or on demand	10,009	–	1,613	11,622
After 1 year but within 2 years	2,581	–	1,021	3,602
After 2 years but within 5 years	18,051	589	3,757	22,397
After 5 years	23	–	13	36
	20,655	589	4,791	26,035
	30,664	589	6,404	37,657

Bank loans, mortgage debenture stock and other borrowings are secured by certain properties, fixed assets and trading financial assets with an aggregate book value of HK$40.8 billion.

Committed borrowing facilities available to Group companies and not yet drawn as at 30 June 2018 amounted to approximately HK$13.0 billion.

Interest Rate Exposure

The Group's interest rate risk arises from treasury activities and borrowings. The Group manages its interest rate exposure with a focus on reducing the Group's overall cost of debt and exposure to changes in interest rates. The Group uses interest rate swaps to manage its interest rate exposure as appropriate.

As at 30 June 2018, approximately 82% of the Group's borrowings were at floating rates and the remaining 18% were at fixed rates. The Group had outstanding interest rate swaps with a notional amount of HK$1.4 billion.

Foreign Currency Exposure

The Group from time to time enters into foreign exchange contracts, which are primarily over-the-counter derivatives, principally for hedging foreign currency exposures and investments.

As at 30 June 2018, there were outstanding foreign exchange contracts with a total notional amount of HK$26.5 billion for hedging of foreign currency equity investments.

Equity Price Exposure

The Group maintains an investment portfolio which comprises majority listed equities. Equity investments are subject to asset allocation limits.

Contingent Liabilities

Details are encapsulated in note 38 "Contingent Liabilities" to the Financial Statements in this annual report.

HUMAN RESOURCES AND TRAINING

The Group employed over 12,900 employees as at 30 June 2018. The Group continued to follow a measured approach towards achieving an optimal and efficient size of its workforce and is committed to providing its staff with ongoing development programmes to enhance productivity and work quality.

The remuneration policy for the Group's employees is reviewed on a regular basis. Remuneration packages are structured to take into account the level and composition of pay and general market conditions in the respective countries and businesses in which the Group operates. Bonus and other merit payments are linked to the financial results of the Group and individual achievement as incentives to optimise performance. In addition, share based award schemes are in place for granting share options and/or free shares to eligible employees to align their long term interests with those of the shareholders and for the purposes of staff motivation and talent retention.