I never imagined, back in May 2003 during the SARS outbreak, that we would be able to end the year on such a positive note.

2003 was an extremely challenging year for the Company, with the unexpected outbreak of SARS causing several of our hotels, including our flagship, The Peninsula Hong Kong, to suffer a single digit occupancy level for a period. I never imagined, back in May 2003 during the SARS outbreak, that we would be able to end the year on such a positive note.

Hotel operations

The hotels that bore the brunt of the impact from the SARS outbreak were The Peninsula Hong Kong, The Kowloon Hotel and The Palace Hotel in Beijing. Each of these hotels was virtually empty for around three months following the outbreak of SARS in China and Hong Kong in late March 2003. Our other properties in Asia, The Peninsula Bangkok and The Peninsula Manila, were also affected as both international and regional travellers cancelled their visits. In the midst of the SARS crisis, we took clear decisions to (i) cut costs wherever possible but maintain our staffing intact without any lay-offs; (ii) put in place marketing plans to capture business aggressively once the SARS outbreak ended; and (iii) use the quiet period to proceed with renovation plans in Beijing and Hong Kong. Our staff also contributed by taking voluntary unpaid leave to ease payroll costs during that period.

I am delighted that all of these strategies have paid off. After the SARS crisis subsided, The Peninsula Hong Kong experienced an extraordinary business rebound, helped by marketing initiatives such as the "Three Peninsula Wishes" and the "75 for 75" rooms and food and beverage offers. Both The Kowloon Hotel and The Peninsula Bangkok also returned to more normal business levels. The renovation of The Palace Hotel was successfully completed and it has seen a significant increase in room rate since its re-launch as The Peninsula Palace in September 2003. Both The Peninsula Hong Kong and The Peninsula Palace benefitted from continued income from their shopping arcades. The loss of income due to SARS was also mitigated by our claim for business interruption insurance in Hong Kong, which recovered HK$95 million.

The Peninsula New York also had a difficult first half year, amidst security fears in the city during the Iraq conflict. However, it ended the year on a high note, with a record operating profit for December. Elsewhere in the USA, both The Peninsula Chicago and The Peninsula Beverly Hills were relatively unaffected by the conflict and performed well. The Peninsula Chicago has continued to establish itself since its opening in 2001 and increased its revenue by some 22% in 2003. The Peninsula Beverly Hills maintained its position as the leader in yield amongst its competitive set.

Quail Lodge was closed for almost five months during the year as it underwent a major renovation of both the guestrooms and the clubhouse. It was re-opened during the summer with a considerably enhanced product and has since been rebuilding its business at higher room rates. There has also been renewed interest in the golf club memberships there.

It was extremely pleasing that our hotels continued to be acknowledged as being amongst the best in the world. Amongst the many awards and accolades received, I would mention in particular the annual *Travel + Leisure* survey in which four of our hotels were ranked in the world's top 20. These were The Peninsula Bangkok (number 1 in the world), The Peninsula Beverly Hills (number 1 in North America), The Peninsula Chicago (number 2 in North America) and The Peninsula Hong Kong.

Overall, the hotels division's revenue and operating profit for the year (including the SARS insurance claim) were HK$2,059 million and HK$337 million, an increase of 6% and 10% respectively as compared to 2002.

Property operations

The yield on our major Hong Kong properties, being The Repulse Bay complex, the Peak Tower and St John's Building, continued to decline during the year, as demand remained weak in the light of Hong Kong's uncertain economy and outlook. The improvement in sentiment towards the end of the year, particularly in the luxury residential sector, has not yet flowed through into our results. Nevertheless, with the long term in mind, we have continued to improve the services for our residents at The Repulse Bay complex by enhancing the residents' club and commencing a phased apartment refurbishment programme. Elsewhere, The Landmark in Ho Chi Minh City, the Thai Country Club and our club and consultancy operations have performed well. Our franchise to operate the Peak Tram has been extended for another 10 years until 2013.

Overall, the revenue and operating profit of the property division fell by 9% and 12% respectively to HK$372 million and HK$253 million.

Finance and results

After consolidating the results of The Peninsula Palace for the first time and inclusive of the SARS insurance claim, the company's turnover and operating profit were at a similar level to the previous year, at HK$2,612 million (up 1% from 2002) and HK$618 million (down 3% from 2002) respectively. Total financing charges reduced from HK$289 million to HK$ 249 million due to a reduced average interest rate and the proceeds of the share placement which raised HK$1,135 million in October 2003. After taking into account the adjustment from various non-operating items, the profit attributable to shareholders for 2003 amounted to HK$351 million, an increase of 20% as compared to 2002. This represented earnings per share of 29 cents (2002 : 25 cents).

The company's balance sheet was strengthened by the proceeds of the share placement as well as the retained earnings for the year. As at 31 December, 2003, the company's net assets had increased by 16% to HK$13,441 million and the gearing ratio had declined to 26%.

With the uncertain business climate, we remained cautious on capital expenditure. Total capital expenditure during 2003, including the renovations of The Peninsula Palace and Quail Lodge, amounted to HK$436 million, as compared to cash generated from operations of HK$651 million, giving rise to a net cash inflow before financing of HK$197 million. With our commitments to the hotel projects in Tokyo and possibly Shanghai, we expect our capital expenditure to increase in the coming years and the directors are therefore recommending to shareholders that the dividend is maintained at 8 cents per share, the same level as last year.

Management

Towards the end of 2003, our finance director, Mark Rhys, retired from the company and has been replaced by Mark Broadley. The other members of the Group Management Committee, being Peter Borer (group general manager-Asia), Niklaus Leuenberger (group general manager-America) and Martyn Sawyer (group general manager-properties and clubs), as well as myself, remain unchanged.

Strategies and developments

Last year, I set out our main strategies as follows :-

(i) to continue the development of new hotels on a measured basis;
(ii) to purify the Peninsula brand and increase its applications across our hotels and other products;
(iii) to seek ways of enhancing the value of our existing assets through new concepts or redevelopments;
(iv) to improve our operating margins; and
(v) to emphasise career development and training for staff.

Our group takes a very long-term view on business and the short-term effects of SARS have not altered our vision and strategies.

On development, significant progress has been made during the year on our hotel project in Tokyo. Working with our partner Mitsubishi Estate Company, we have advanced our detailed designs to the point of shortly inviting tenders from contractors. It is expected that demolition of the existing Hibiya Park Building will begin shortly so that construction of the hotel will commence before the end of 2004.

We have pursued discussions in Shanghai with the aim of developing a Peninsula hotel on a site in the Waitanyuan area of the Bund, close to the old British Consulate. A framework agreement was signed in November 2003 to further discussions on the acquisition of this site in conjunction with a Shanghai developer and we are presently in detailed negotiations, which may lead to final agreements being signed. While there is much to do before this project will be realised, the prospect of the group returning to its roots in Shanghai is exciting.

On branding, we have introduced a new Peninsula brand image in conjunction with the re-launch of The Peninsula Palace hotel in Beijing, which will now be applied consistently across all Peninsula hotels. We will continue to look for suitable applications for our brand name, such as the new Peninsula chocolate boutique, which was opened at Hong Kong International Airport in late 2003.

On existing assets, the major renovations at The Peninsula Palace and Quail Lodge have breathed new life into those properties. The new Thai restaurant, *Thiptara*, and the *River Café* have enhanced the dining facilities at The Peninsula Bangkok and *The Pen-Top Bar* in The Peninsula New York will shortly be renovated. Guestroom refurbishments have also taken place in the Peninsulas in Hong Kong and Beverly Hills.

We have also focussed attention on our property assets. At The Repulse Bay complex, a programme to refurbish existing apartments has commenced and the residents' clubhouse continues to undergo improvements. We are also studying a major renovation scheme to create a new layout with improved retail and restaurant concepts at The Peak Tower.

On operating margins, in addition to the cost saving initiatives generated in response to SARS, we have continued to work on improving our procurement practices through the establishment of a central purchasing office in Hong Kong and a review of our food purchasing practices.

On staff development and training, the Group Management Development Programme has been a success, with participants deriving significant value from the courses, the projects and the interaction with other participants. We have therefore launched a further Group Professional Development Programme for managers and supervisors. In the meantime, we continue to believe in practical training, and cross-exposure between hotels is commonplace.

Outlook

The challenges encountered during 2003 have once again reinforced our long-term philosophy towards the ownership and management of hotels. In today's uncertain world, short-term fluctuations, both positive and negative, are inevitable but, as demonstrated during the SARS crisis, we will not vary our long-term commitment to our investment, our staff and our standards. We believe that this commitment was a key factor in our strong recovery after SARS.

Whilst we experienced positive trends in our hotel business at the end of 2003 and the beginning of 2004, the travel industry in general remains uncertain. Nevertheless, we believe that all of our hotels are well placed to compete in their respective markets. We are also positive about the prospects for The Peninsula Palace and Quail Lodge with the renovated products there.

In the longer term, we believe that the efforts which we continue to make to enhance our existing properties, as well as the new developments in Tokyo and possibly Shanghai, will bring increased value.

With more positive economic indicators and confidence in Hong Kong, we would expect to see stability or perhaps a recovery in our property businesses. Again, we would expect our refurbishment efforts to yield positive results.

Finally, the celebrations for the 75th anniversary of The Peninsula Hong Kong were concluded with a gala evening attended by many friends of the hotel, and business associates. Over the years, this hotel has become synonymous with Hong Kong itself, both as a tourist destination but more importantly as a venue of which the local community is fond and to which it feels attached. It is this longevity and recognition that we strive for in all of our hotels.

Clement King Man Kwok
26 February 2004