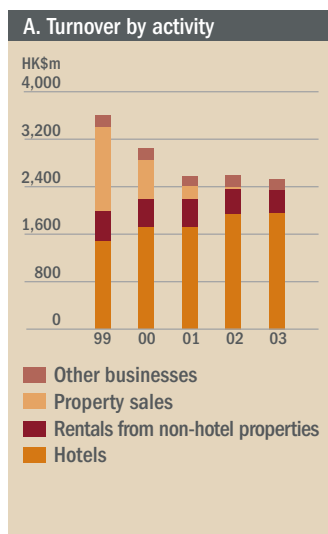


Income statement



Turnover

Total turnover for the year decreased by 3% compared to 2002 after including, for the first time, The Peninsula Palace Beijing following the completion of the restructuring of the asset in 2002. Revenues without the inclusion of this hotel would have been HK\$2,355 million in 2003 (2002: HK\$2,592 million).

Turnover was affected during the year by the outbreak of SARS in Asia, which had a considerable impact on occupancies and revenues at the group's properties in Hong Kong, Beijing and, to a lesser extent, Bangkok. Major renovation programmes during the year at The Peninsula Palace and Quail Lodge also resulted in a disruption of revenues for significant parts of the year.

The table below sets out the breakdown of revenues by business sector and geographical segment.

| HK\$m | 2003 | | 2002 | | Change |
|--|--------------|-------------|-------|------|--------|
| Hotels | | | | | |
| Rooms | 835 | 33% | 847 | 33% | (1%) |
| Food and beverage | 565 | 23% | 575 | 22% | (2%) |
| Commercial | 384 | 15% | 305 | 12% | 26% |
| Other | 189 | 8% | 214 | 8% | (12%) |
| | 1,973 | 79% | 1,941 | 75% | 2% |
| Rentals from non-hotel properties | | | | | |
| Residential | 287 | 11% | 320 | 12% | (10%) |
| Office | 32 | 1% | 34 | 1% | (6%) |
| Shopping arcade | 53 | 2% | 56 | 2% | (5%) |
| | 372 | 14% | 410 | 15% | (9%) |
| Property sales | - | - | 39 | 2% | - |
| Other businesses | 172 | 7% | 202 | 8% | (15%) |
| | 2,517 | 100% | 2,592 | 100% | (3%) |
| Arising in | | | | | |
| Hong Kong | 1,313 | 52% | 1,541 | 60% | (15%) |
| Other Asia Pacific | 384 | 15% | 242 | 9% | 59% |
| United States of America | 820 | 33% | 809 | 31% | 1% |

Hotels During 2003, rooms in the hotels in which we have a majority shareholding ("owned hotels") generated total room revenue of HK\$835 million, a drop of 1% from the previous year. Food and beverage revenues decreased by 2% year-on-year and commercial revenues were enhanced by the consolidated contribution from The Peninsula Palace.

The severe drop in occupancy in the group's Asian properties due to SARS led to a corresponding decrease in turnover from other hotel income, which includes income from retail outlets operated by The Peninsula Hong Kong and from departments such as spas, telephones, guest transportation and laundry.

To help address the impact of SARS, The Peninsula Hong Kong and The Kowloon Hotel introduced a number of special promotions on food and beverage and functions during the year. These created significant demand from local Hong Kong residents and helped the recovery in business at both properties. In Beijing, the accelerated renovation programme and considerably enhanced product quality has positioned the hotel to enhance further its competitive standing in the market. The Peninsula Bangkok, which saw a substantial reduction in long haul hotel guests due to the impact of the Iraq conflict and SARS, recovered well and came close to achieving the same level of income as in 2002.

In the United States, a surge in revenue from The Peninsula Chicago reflected its improved occupancy and rates and its growing popularity with the local community, whilst The Peninsula New York, affected by the Iraq conflict for a period, finished the year positively. Re-opened in July 2003, Quail Lodge's revenues, especially in food and beverage, show a marked improvement over the previous year, following increased use of the new facilities on the property. The renovations at the hotel have, as expected, enabled the asset to generate better rates.

Commercial revenues from the hotels' shopping arcades were more resilient during the year. The Peninsula Palace's arcade is regarded as the premier brand shopping experience in Beijing and the physical improvements to the property have not only enhanced its attractiveness to high-end retailers and customers, but also enabled it to command premium rates. Improving sentiment in Hong Kong led to a small increase in revenue from The Peninsula Hong Kong's arcade, although The Kowloon Hotel found itself in a much more competitive situation. The Peninsula Bangkok managed to double its rental income.

The breakdown of revenues by property is as follows:

| HK\$m | 2003 | | | | 2002 | | | |
|------------------------------|--------------|------------|------------|------------|--------------|------------|------------|------------|
| | Room | F&B | Commercial | Other | Room | F&B | Commercial | Other |
| Owned hotels | | | | | | | | |
| The Peninsula Hong Kong | 149 | 196 | 253 | 42 | 199 | 239 | 252 | 64 |
| The Peninsula New York | 227 | 66 | 26 | 59 | 224 | 71 | 26 | 59 |
| The Peninsula Chicago | 193 | 122 | - | 40 | 148 | 104 | - | 34 |
| The Peninsula Bangkok | 90 | 51 | 2 | 11 | 97 | 52 | 1 | 13 |
| The Peninsula Palace Beijing | 50 | 27 | 79 | 6 | - | - | - | - |
| The Kowloon Hotel | 104 | 85 | 24 | 8 | 143 | 102 | 26 | 12 |
| Quail Lodge Resort | 22 | 18 | - | 3 | 36 | 7 | - | 4 |
| | 835 | 565 | 384 | 169 | 847 | 575 | 305 | 186 |
| Managed hotels | | | | | | | | |
| The Peninsula Beverly Hills | 189 | 83 | - | 45 | 174 | 77 | - | 42 |
| The Peninsula Manila | 64 | 54 | 2 | 19 | 66 | 60 | 2 | 22 |
| The Peninsula Palace Beijing | - | - | - | - | 96 | 50 | 72 | 13 |
| | 253 | 137 | 2 | 64 | 336 | 187 | 74 | 77 |
| | 1,088 | 702 | 386 | 233 | 1,183 | 762 | 379 | 263 |

Note: Revenue on managed hotels is not consolidated in the financial statements of the group. However, management and marketing fees of HK\$20 million were received from these hotels (2002: HK\$28 million).

Rentals from non-hotel properties Total rental revenue from non-hotel properties was HK\$372 million, a decline of 9% compared to 2002. This decline was principally attributable to the fragile corporate sentiment during the year, which depressed the performance of The Repulse Bay complex, the group's largest contributor of rental income from non-hotel properties.

| HK\$m | 2003 | | | 2002 | | |
|------------------------------------|-------------|-----------|-----------------|-------------|--------|-----------------|
| | Residential | Office | Shopping arcade | Residential | Office | Shopping arcade |
| The Repulse Bay complex, Hong Kong | 276 | - | 32 | 309 | - | 32 |
| The Peak Tower, Hong Kong | - | - | 20 | - | - | 23 |
| St John's Building, Hong Kong | - | 15 | 1 | - | 17 | 1 |
| The Landmark, Ho Chi Minh City | 11 | 17 | - | 11 | 17 | - |
| | 287 | 32 | 53 | 320 | 34 | 56 |

Of the unfurnished and serviced apartments available at The Repulse Bay complex, the latter have found a greater level of support following their renovation. Reconfiguration and renovations of the unfurnished apartments now under way are expected to increase their appeal as the economic climate improves further.

The Peak Tower suffered from the SARS-related downturn, as visitor numbers dropped and local residents stayed at home. Occupancy and rates at St John's Building held up relatively well in the face of the oversupply of new inventory in Central district, while The Landmark continues to perform strongly despite newer property coming on stream.

Property sales There were no property sales during 2003. The Thai Country Club real estate sales programme has yet to commence.

Other businesses Revenue from the Thai golf course was particularly strong, improving by 18% over the previous year, whilst the renovations at Quail Lodge reduced usage and fees. Income from the Peak Tram and Peak Entertainment fell along with the number of visitors during the SARS period. Similarly, Tai Pan Laundry's results were lower due to the lack of hotel guests, and the severe drop in restaurant business. Conversely, food and beverage at The Repulse Bay held firm as customers sought open-air dining in preference to enclosed restaurants. Peninsula Clubs and Consultancy Services performed well.

Other revenue

Other revenue includes a one-time insurance settlement of HK\$95 million receivable in compensation for the estimated loss of profits incurred by certain of the group's Hong Kong operations resulting from the outbreak of SARS during 2003.

Operating costs

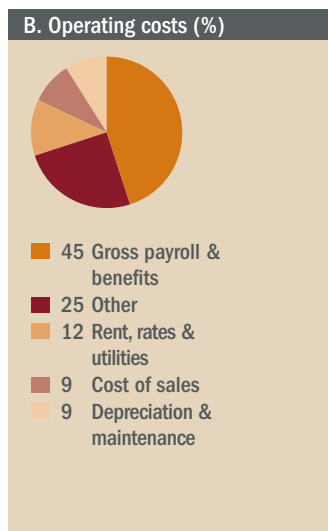
An analysis of the operating costs of HK\$1,998 million is set out in chart B at page 47. These are 2% higher than 2002 as a result of the incorporation of The Peninsula Palace Beijing into the accounts.

Excluding the results of The Peninsula Palace, the group achieved a reduction in operating expenses of 9% in the first half of the year. This was largely a result of the implementation of strategic measures to contain costs given the challenging business environment created by SARS.

In the second half of the year, deferred marketing activities were re-activated and operating costs returned to a more normal level following the removal of the threat of SARS. The group recorded overall savings of 4% in operating expenses in 2003 compared to 2002.

HK\$901 million or 45% of direct operating costs are payroll-related. This proportion remains the same as the previous year, as the ratio of payroll costs to total operating costs in The Peninsula Palace is lower than in the other hotels. The breakdown of employee numbers at 31 December was as follows:

| | 2003 | | | 2002 |
|--------------------------|--------------|--------------|--------------|--------------|
| | Direct | Managed | Total | Total |
| Hotels | 3,546 | 1,089 | 4,635 | 4,746 |
| Property | 222 | - | 222 | 233 |
| Other businesses | 667 | 580 | 1,247 | 1,265 |
| | 4,435 | 1,669 | 6,104 | 6,244 |
| Hong Kong | 1,705 | 580 | 2,285 | 2,325 |
| Other Asia Pacific | 1,576 | 725 | 2,301 | 2,402 |
| United States of America | 1,154 | 364 | 1,518 | 1,517 |
| | 4,435 | 1,669 | 6,104 | 6,244 |



The decrease in hotel employees is mainly attributable to The Peninsula Palace Beijing as rooms were closed for renovation and the number of restaurant facilities were reduced in the renovated product. Natural attrition and the freezing of non-critical positions in the Peninsulas in Hong Kong and New York further reduced the total. These reductions were offset by increased manpower in The Peninsula Bangkok, which opened a new restaurant, and in The Peninsula Chicago where the growth in business volume demanded more manpower. The reduced number of staff under “Other businesses” is mainly attributable to natural attrition within the operations managed by Peninsula Clubs.

Total cost to the group of contributions to all the defined contribution retirement plans in Hong Kong, other Asia Pacific countries and the USA amounted to HK\$55 million, compared to HK\$51 million in 2002. The increase is due to the absorption of the retirement scheme for The Peninsula Palace Beijing.

Operating profit

Operating profit represents profit before non-operating items, financing charges, taxation and minority interests. Operating profit is analysed as follows:

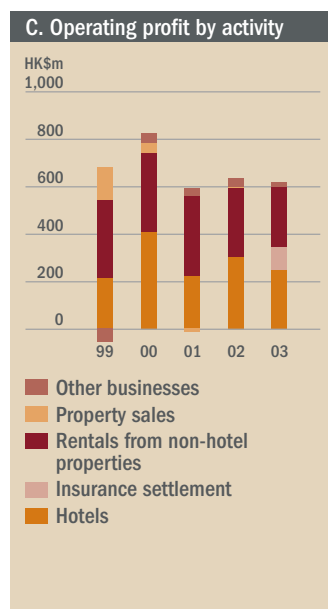
| HK\$m | Hong Kong | Other Asia Pacific | United States of America | Total | Change |
|-----------------------------------|------------|--------------------------|--------------------------------|------------|--------------|
| 2003 | | | | | |
| Hotels | 232 | 71 | (52) | 251 | (18%) |
| Rentals from non-hotel properties | 237 | 15 | - | 252 | (13%) |
| Property sales | - | - | - | - | - |
| Other businesses | 20 | 9 | (9) | 20 | (41%) |
| | 489 | 95 | (61) | 523 | (18%) |
| Insurance settlement | 95 | - | - | 95 | |
| | 584 | 95 | (61) | 618 | (3%) |
| 2002 | | | | | |
| Hotels | 333 | 40 | (68) | 305 | |
| Rentals from non-hotel properties | 274 | 15 | - | 289 | |
| Property sales | - | (6) | 15 | 9 | |
| Other businesses | 33 | 8 | (7) | 34 | |
| | 640 | 57 | (60) | 637 | |

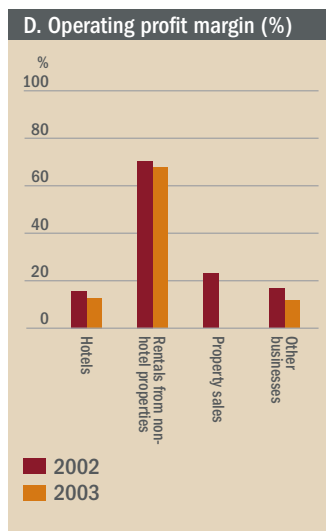
Operating profit decreased by 18% to HK\$523 million in 2003. Including the insurance settlement for business interruption of HK\$ 95 million, the operating profit would have been HK\$618 million, or a 3% decrease compared to 2002.

Hotels The hotels performed reasonably well given the challenges during the first half of the year, with profit from this segment also decreasing by 18%. The contribution of The Peninsula Palace Beijing and significantly reduced losses at The Peninsula Chicago helped offset the drop in profit of the other Asian hotels and losses at Quail Lodge Resort and The Peninsula New York.

Rentals from non-hotel properties Profit from rentals in non-hotel properties decreased by 13% to HK\$252 million, with the biggest drop being recorded by The Repulse Bay. The complex continued to be challenged in a market beset by poor sentiment and the impact of SARS. St John's Building and The Peak Tower experienced a similar decline in percentage terms. The Landmark, however, remained steady in a fairly buoyant market.

Other businesses Profit from other businesses dropped by 41%, contributing HK\$20 million versus HK\$34 million in 2002. Improved performances from the Thai golf club, the private clubs management business, and a steady level of profit at the Peak Tram were offset by the administrative overheads and reduced revenue at Quail Lodge, and lower profits in other businesses such as Tai Pan Laundry.





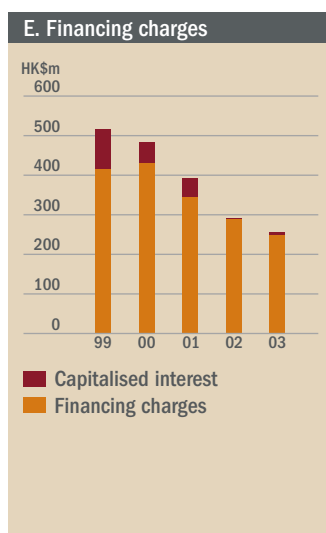
Operating profit margin

Operating profit margin represents operating profit as a percentage of turnover and is analysed as follows:

| | 2003 | 2002 |
|---|------|------|
| Hotels | 13% | 16% |
| Rentals from non-hotel properties | 68% | 70% |
| Property sales | - | 23% |
| Other businesses | 12% | 17% |
| Profit margin (before insurance settlement) | 21% | 25% |
| Arising in | | |
| Hong Kong | 37% | 42% |
| Other Asia Pacific | 25% | 24% |
| United States of America | (7%) | (7%) |

The profit margin fell to 21%, compared to 25% in 2002. This was almost wholly due to the impact of SARS on the group's Hong Kong operations covering hotels, rentals and other businesses.

Because of the fixed cost element in operating costs, the percentage reduction in operating profit is greater than the percentage reduction in turnover. Without The Peninsula Palace Beijing, the operating profit margin would have decreased to 20%.



Non-operating items

The annual third party revaluation of the group's properties resulted in an increase in value of certain properties over 2002. A reversal of revaluation deficit and impairment loss previously recorded at several properties totalling HK\$66 million was made in 2003. The results of the annual property revaluation are summarised on pages 51 to 53.

Financing charges

Total financing charges on borrowings in 2003 amounted to HK\$253 million. Of this HK\$4 million was capitalised in respect of projects under development, giving a net charge to the income statement of HK\$249 million. The weighted average gross interest rate in 2003 was 4.4%, compared to 5.1% in 2002.

Interest cover has improved, with operating profit at 2.5 times net financing charges for the year.

Associated companies

This mainly represents the group's share of the results of The Peninsula Manila (40%).

Taxation

Taxation comprises the current taxation charge and net deferred tax charges and credits. The current taxation charge is estimated on the basis of expected tax payable on taxable income for the year at current rates applicable in the relevant jurisdictions. Current taxation has grown by HK\$4 million due to the increased profits after financing charges.

Deferred tax charges or credits are provided for all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profits in accordance with the Statement of Standard Accounting Practice 12 (Revised) "Income taxes" ("SSAP 12 (Revised)") that became effective on 1 January 2003.

In prior years, deferred tax was only provided for the taxation effect arising from timing differences between the accounting and tax treatment of income and expenditure that was expected with reasonable probability to be realised in the foreseeable future. The adoption of SSAP 12 (Revised) represents a change in accounting policy and has resulted in a net additional deferred taxation charge amounting to HK\$20 million and HK\$17 million for the years ended 2003 and 2002 respectively. The additional deferred taxation incurred in 2003 was partially offset by the HK\$6 million deferred tax credit or asset arising from unutilised tax losses generated by the Hong Kong subsidiaries in previous years, due to the increase in profits tax rate from 16% to 17.5% announced by the Hong Kong Government in March 2003.

Minority interests

The charge represents the share of profits attributable to the local joint venture partners in The Landmark (30%) and Thai subsidiaries (25%).

Dividends

No interim dividend was declared during the year 2003. In light of the group's ongoing capital expenditure requirements, the directors have recommended the payment of a final dividend of 8 cents per share.

The proposed dividend equates to a yield of 1.5% based on the closing share price of HK\$5.35 on 26 February 2004. The total distribution amounts to HK\$112 million.

Balance sheet

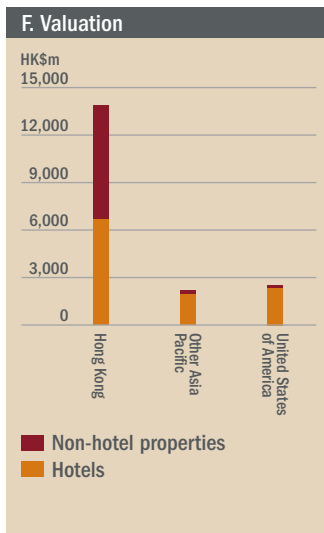
Fixed assets

The group owns and manages nine hotels in Asia and the United States of America. In addition to hotel investments, the group owns residential apartments, office towers and shopping arcades for rental purpose.

A summary of hotel, property and other assets with valuations attributable to the group at 31 December 2003 is listed as follows:

| | Total Property GFA (sf) | Net Lettable Area | | | Valuation (HK\$m) | HSH Interest | Attributable Value (HK\$m) |
|--|----------------------------------|----------------------------|----------------|---------------------|----------------------|-----------------|----------------------------------|
| | | Shopping Arcade (sf) | Office (sf) | Residential (sf) | | | |
| Hotel Assets | | | | | | | |
| Owned Hotels | | | | | | | |
| The Peninsula Hong Kong <i>Lease Expiry Jan-2072</i> | 604,097 | 72,522 | 71,531 | - | 5,484 | 100% | 5,484 |
| The Peninsula New York <i>Lease Expiry Aug-2078</i> | 305,870 | 7,574 | - | - | 789 | 100% | 789 |
| The Peninsula Chicago* <i>Freehold/Leasehold</i> | 403,219 | - | - | - | 1,321 | 92.5% | 1,222 |
| The Peninsula Bangkok <i>Freehold/Leasehold</i> | 711,327 | 2,831 | - | - | 631 | 75% | 473 |
| The Peninsula Palace Beijing <i>Lease Expiry Nov-2033</i> | 790,902 | 77,529 | - | - | 1,280 | 42.13% | 539 |
| The Kowloon Hotel <i>Lease Expiry Jun-2039</i> | 361,985 | 40,813 | - | - | 1,193 | 100% | 1,193 |
| Quail Lodge Resort* <i>Freehold</i> | 1,679,231 | - | - | - | 232 | 100% | 232 |
| | <u>4,856,631</u> | <u>201,269</u> | <u>71,531</u> | <u>-</u> | <u>10,930</u> | | <u>9,932</u> |
| Managed Hotels | | | | | | | |
| The Peninsula Beverly Hills | | | | | 1,069 | 20% | 214 |
| The Peninsula Manila | | | | | 220 | 40% | 88 |
| | | | | | <u>1,289</u> | | <u>302</u> |
| Total Hotel Assets | | | | | <u>12,219</u> | | <u>10,234</u> |
| Property Assets | | | | | | | |
| The Repulse Bay <i>Lease Expiry May-2068</i> | 805,990 | 26,026 | - | 376,893 | 3,819 | 100% | 3,819 |
| Repulse Bay Apartments <i>Lease Expiry Mar-2071</i> | 710,763 | - | - | 418,692 | 2,622 | 100% | 2,622 |
| Repulse Bay Garage <i>Lease Expiry Sep-2070</i> | 36,438 | 16,934 | - | - | 69 | 100% | 69 |
| The Peak Tower <i>Lease Expiry Mar-2031</i> | 116,574 | 41,093 | - | - | 327 | 100% | 327 |
| St. John's Building <i>Lease Expiry Aug-2114</i> | 103,882 | 534 | 60,783 | - | 257 | 100% | 257 |
| The Landmark <i>Lease Expiry Jan-2026</i> | 221,866 | - | 80,342 | 54,821 | 91 | 70% | 64 |
| Thai Country Club <i>Freehold</i> | 7,406,035 | - | - | - | 169 | 75% | 127 |
| Quail Lodge Golf Club <i>Freehold</i> | 5,838,384 | - | - | - | 125 | 100% | 125 |
| Total Property Assets | <u>15,239,932</u> | <u>84,587</u> | <u>141,125</u> | <u>850,406</u> | <u>7,479</u> | | <u>7,410</u> |

| | Total Property GFA (sf) | Net Lettable Area | | | Valuation (HK\$m) | HSH Interest | Attributable Value (HK\$m) |
|--|----------------------------------|----------------------------|----------------|---------------------|----------------------|-----------------|----------------------------------|
| | | Shopping Arcade (sf) | Office (sf) | Residential (sf) | | | |
| Other Assets | | | | | | | |
| Phuket Land <i>Freehold</i> | 2,411,317 | - | - | - | 113 | 75% | 85 |
| Vacant land near Bangkok <i>Freehold</i> | 15,041,557 | - | - | - | 255 | 75% | 192 |
| Quail Lodge Land <i>Freehold</i> | 15,465,309 | - | - | - | 54 | 100% | 54 |
| Po Yip Building, Flat 2, 1/F <i>Lease Expiry Jun-2047</i> | 20,594 | - | - | - | 14 | 100% | 14 |
| 1 Lugard Road <i>Lease Expiry Jan-2077</i> | 4,938 | - | - | - | 2 | 100% | 2 |
| Sun Hing Building, Units 1 & 2, 5/F <i>Lease Expiry Jul-2120</i> | 4,694 | - | - | - | 3 | 100% | 3 |
| Total Other Assets | 32,948,409 | - | - | - | 441 | | 350 |
| Total Hotel, Property and Other Assets | 53,044,972 | 285,856 | 212,656 | 850,406 | 20,139 | | 17,994 |



* In line with the group's accounting policies, *The Peninsula Chicago* (a hotel newly opened in 2001) and *Quail Lodge Resort* (a hotel newly renovated in 2003) were not subject to third party valuations at the end of the year as they were considered not to have reached a steady state of operation. These two properties are stated above at cost less any provision required.

Third party valuations of the group's hotel and investment properties were carried out as at 31 December 2003. In line with the group's accounting policies, residential apartments, shopping arcades (including those at hotels), office towers and golf courses are treated as investment properties, and the surpluses or deficits so arising are dealt with in the investment properties revaluation reserves on a portfolio basis.

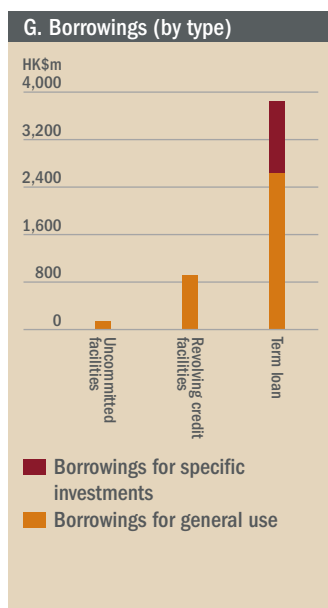
Following the completion of the renovation at Quail Lodge during the year, various elements of the property were reclassified from property under development to hotel and investment properties.

The treatment of surpluses and deficits arising from revaluation are summarised below:

| HK\$m | Hotel properties | | | Total | Investment properties | Grand Total |
|-------------------------------------|------------------|--------------------|----------------------|------------|-----------------------|-------------|
| | Income Statement | Minority Interests | Revaluation Reserves | | Revaluation Reserves | |
| Owned hotels | | | | | | |
| The Peninsula Hong Kong | - | - | (50) | (50) | 76 | 26 |
| The Peninsula New York | 60 | - | - | 60 | 40 | 100 |
| The Peninsula Chicago* | - | - | - | - | - | - |
| The Peninsula Bangkok | 2 | (1) | - | 1 | - | 1 |
| The Peninsula Palace Beijing | - | - | 93 | 93 | 28 | 121 |
| The Kowloon Hotel | - | - | 19 | 19 | 11 | 30 |
| Quail Lodge Resort* | - | - | - | - | - | - |
| Owned hotels | 62 | (1) | 62 | 123 | 155 | 278 |
| Non-hotel properties | | | | | | |
| The Repulse Bay complex | | | - | | 333 | 333 |
| The Peak Tower | | | - | | 6 | 6 |
| St John's Building | | | - | | (17) | (17) |
| The Landmark | | | - | | 10 | 10 |
| Thai Country Club | | | - | | - | - |
| Quail Lodge Golf Club | | | - | | (42) | (42) |
| | | | | | 445 | 568 |
| Revaluation reserves at 1 January | | | 591 | | 8,157 | |
| Prior year adjustment ** | | | - | | (17) | |
| Revaluation reserves at 31 December | | | <u>653</u> | | <u>8,585</u> | |

*No revaluation was made to newly opened or newly renovated hotels which are considered not to have reached a steady state of operation.

**Prior year adjustment was made as a result of change in accounting policy for income tax.



Other investments

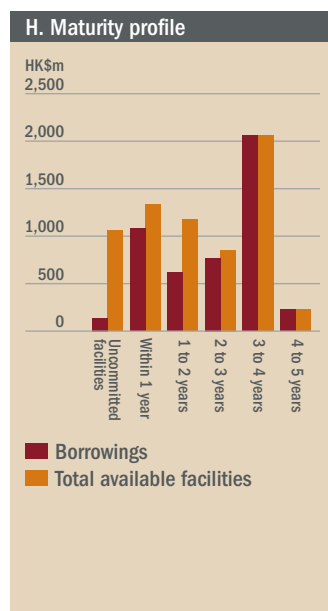
Other investments mainly comprise the group's minority shareholding in The Peninsula Beverly Hills (20%), and an investment in a site in Jakarta (20%), which is being held for possible future development.

Investment in hotel management contract

The group acquired the hotel management contract in The Peninsula Beverly Hills in 1991. This payment is amortised over the 45-year term of the contract until 2036.

Borrowings

Gearing, expressed as the percentage of net borrowings to the total of net borrowings and net assets, at 26% remains well within the debt capacity of the group. Care is taken to ensure that borrowing facilities do not impose onerous or restrictive covenants, and that the terms of the facilities match the underlying requirements. Borrowings are managed centrally and are not normally earmarked for specific investments other than those arranged to fund specific projects, like The Peninsula Chicago, The Peninsula Tokyo, The Peninsula Palace in Beijing and the investments in Thailand.



In addition to the borrowings of the group, The Peninsula Manila (40%-owned by the group) and The Peninsula Beverly Hills (20%) obtain bank borrowings directly. These borrowings are not consolidated in the balance sheet as these two investments are not subsidiaries of the company. Consolidated and non-consolidated borrowings at 31 December 2003 are summarised as follows:

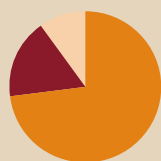
| HK\$m | 2003 | | | Total | 2002 Total |
|--|--------------|--------------------|--------------------------|--------------|---------------|
| | Hong Kong | Other Asia Pacific | United States of America | | |
| Consolidated borrowings | | | | | |
| For general use | 3,342 | 139 | 213 | 3,694 | 4,592 |
| For specific investments | - | 605 | 607 | 1,212 | 1,251 |
| Consolidated borrowings | 3,342 | 744 | 820 | 4,906 | 5,843 |
| Off balance sheet borrowings attributable to the group, for specific investments | | | | | |
| The Peninsula Manila (40%) | - | 5 | - | 5 | 4 |
| The Peninsula Beverly Hills (20%) | - | - | 123 | 123 | 123 |
| Off balance sheet borrowings | - | 5 | 123 | 128 | 127 |
| Consolidated and non-consolidated borrowings | 3,342 | 749 | 943 | 5,034 | 5,970 |
| Pledged assets attributable to the group | | | | | |
| For consolidated borrowings | - | 1,281 | 1,406 | 2,687 | 3,344 |
| For off balance sheet borrowings | - | 88 | 393 | 481 | 399 |
| | - | 1,369 | 1,799 | 3,168 | 3,743 |

Borrowing requirements are not seasonal as the group benefits from a steady inflow of income from its leased properties and there is only minor seasonality in its hotel operations. Borrowing requirements tend to follow the pattern of capital expenditure and investment at the properties.

In October 2003, in order to strengthen the group's capital base and financial flexibility, the company completed a top-up share placement. Under the placement, two substantial shareholders of the company, Mikado Holdings Inc. and New Xenon Holding Corporation (formerly know as Xenon Holding Corporation), sold 160 million ordinary shares to independent investors at HK\$4.90 per share and thereafter subscribed at the same price for 233 million new shares of the company. After deduction of expenses incurred in the placement, the net proceeds raised by the company were HK\$1,135 million, being the issue of 233 million shares at a net price of HK\$4.85 each. The closing price of the company's shares on 20 October 2003, the date on which the placement was agreed, was HK\$5.45. Pending utilisation of the funds for the development of new hotels and the continuing refurbishment or renovation of the group's existing hotels and properties, most of the net proceeds were applied towards reducing short-term bank borrowings. As a result, the net borrowings of the group decreased by 16% during 2003 to HK\$4,689 million.

During the year, the group refinanced some of its borrowing facilities on better terms, and made use of financial instruments to further reduce the borrowing costs while managing the financial risks of the borrowings (see page 56). After those refinancing exercises, secured borrowings decreased to HK\$814 million, representing 17% of the net borrowings, and the corresponding value of pledged assets amounted to HK\$2,687 million.

I. Capital expenditure (%)



- 73 Major renovations in certain properties
- 17 Capital expenditure at other existing properties
- 10 New project development

Cash flow

Operating profit before depreciation and amortisation (also known as “EBITDA”) in 2003 decreased marginally by 3% to HK\$726 million. This figure includes the compensation claim of HK\$95 million agreed with an insurance company in respect of the business interruption suffered by the group as a result of SARS which was accrued at 31 December 2003 but received after the year end date. As a result of the timing adjustment of the insurance claim proceeds, net cash generated from operating activities amounted to HK\$627 million, as compared to HK\$772 million in 2002. Operating cash flow was supplemented by the share placement by the company in October 2003, which raised HK\$1,135 million. This further strengthened the company’s financial flexibility and cash position.

In order to minimise interest costs, bank borrowings totalling HK\$989 million were repaid during the year primarily from the proceeds of the placement. As a result of the group’s reduction of its borrowings and through effective management of its interest costs, interest payable fell to HK\$255 million compared to HK\$291 million in 2002.

Capital expenditure in 2003 totalled HK\$436 million and is summarised below:

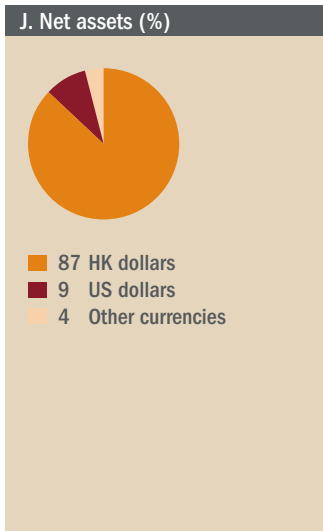
| HK\$m | 2003 | 2002 |
|--|------------|------------|
| New project development | 45 | 99 |
| Major renovations in certain properties | 318 | 33 |
| Capital expenditure at other existing properties | 73 | 74 |
| Net cash used to acquire The Peninsula Palace, Beijing | - | 70 |
| | 436 | 276 |

The figures above include the two major renovation programmes for The Peninsula Palace and Quail Lodge. As a result of the renovations, the former is now positioned at the forefront of its competitive set whilst Quail Lodge has an attractive quality product with which to build its business. In addition to this major refurbishment of existing properties, the group spent HK\$45 million on new projects, including Tokyo. It is expected that construction of that property will commence in 2004 and, accordingly, the group’s capital expenditure in relation to that project is anticipated to rise over the next three years. The remaining capital expenditure of HK\$73 million was spent on upkeep of other existing properties, which is a similar level of spending to 2002.

Risk management

The group emphasises risk minimisation and hedges its exposure to financial risks. Various techniques and financial instruments are used to control or reduce the financial risks.

Foreign exchange risk The group manages its foreign exchange exposure with a view to protecting its net assets and profitability against adverse fluctuations in exchange rates. The parent company of the group is a Hong Kong corporation, reporting its results and accountable to its shareholders in Hong Kong dollars. In the light of the Hong Kong dollar peg, the group has not hedged exposure to certain US dollar denominated net assets. It therefore aims to preserve its value in Hong Kong dollar and/or United States dollar terms.



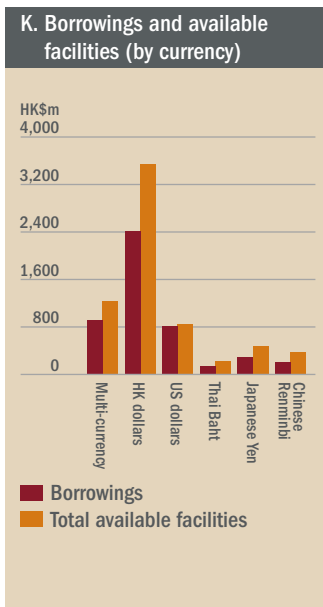
Significant foreign currency transactional requirements are locked into fixed exchange rates primarily by forward exchange contracts at the time of commitment. As at 31 December 2003, after accounting for a forward exchange contract designed to hedge net investment in Thailand and certain currency swaps designed to hedge foreign exchange risk of foreign currency borrowings, 87%, 9% and 4% of the group's net assets are denominated in Hong Kong dollars, United States dollars and other currencies respectively. Other currencies mainly include Thai Baht, Indonesian Rupiah, Philippine Peso, Vietnamese Dong, Japanese Yen and Chinese Renminbi.

Every effort is made to match assets and liabilities in terms of currency in order to minimise the translation exposures. In the event of the mismatching of currencies (other than Hong Kong dollars versus United States dollars), forward exchange contracts are sometimes used to manage the risk arising from translating financial statements of foreign subsidiaries and investments. As at 31 December 2003 the group had entered into a forward exchange contract of Baht 2.5 billion to hedge the translation exposure of Thai subsidiaries. Even after the forward exchange hedging, some translation exposures exist in Asian countries and general reserves have been debited with HK\$35 million in 2003 in respect of this net translation loss.

Interest rate risk The group's borrowings bear floating interest rates that are reset on a regular basis as market rates change on a regular basis. As the borrowing costs are subject to market fluctuations in interest rates, the group has a long-term policy to fix approximately 50% of its borrowings by way of interest rate swaps and other derivatives. At 31 December 2003, the interest rates on 62% of the borrowings were fixed.

Liquidity risk The group manages its liquidity risk by obtaining sufficient committed borrowing facilities to meet its obligations and commitments. At 31 December 2003, total available facilities amounted to HK\$6.7 billion, of which 73% was drawn down. The balance of undrawn committed facilities of HK\$899 million is in the form of revolving credit and term loan facilities.

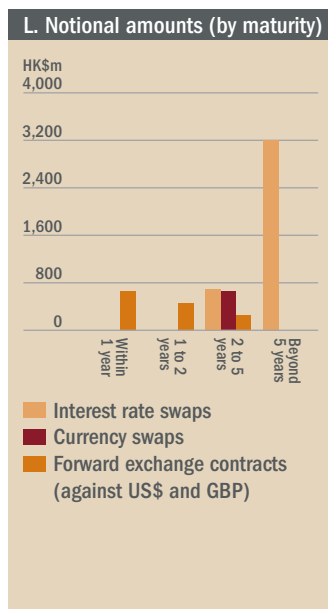
The group also manages its maturity profile of borrowings and facilities to maximise liquidity and minimise refinancing risk.



Off-balance sheet financial instruments

Off-balance sheet financial instruments are held for hedging purposes to manage foreign exchange and interest rate risks. Effective controls are implemented to identify and monitor these risks.

During the year, the group took advantage of the low interest rate environment and entered into interest rate swaps to fix interest rates of certain borrowings. Also, the group raised foreign currency borrowings coupled with currency swaps to reduce the borrowing costs.



The notional amounts and the fair value of the off-balance sheet financial instruments as at 31 December 2003 are as follows:

| HK\$m | Classified as | | | | Total | |
|----------------------------|------------------|--------------|---|-------------|------------------|--------------|
| | Cash flow hedges | | Hedges of net investments in foreign entities | | | |
| | Notional amounts | Fair value | Notional amounts | Fair value | Notional amounts | Fair value |
| Interest rate swaps | 3,904 | (268) | - | - | 3,904 | (268) |
| Currency swaps | 657 | 29 | - | - | 657 | 29 |
| Forward exchange contracts | 925 | (21) | 458 | (37) | 1,383 | (58) |
| | 5,486 | (260) | 458 | (37) | 5,944 | (297) |

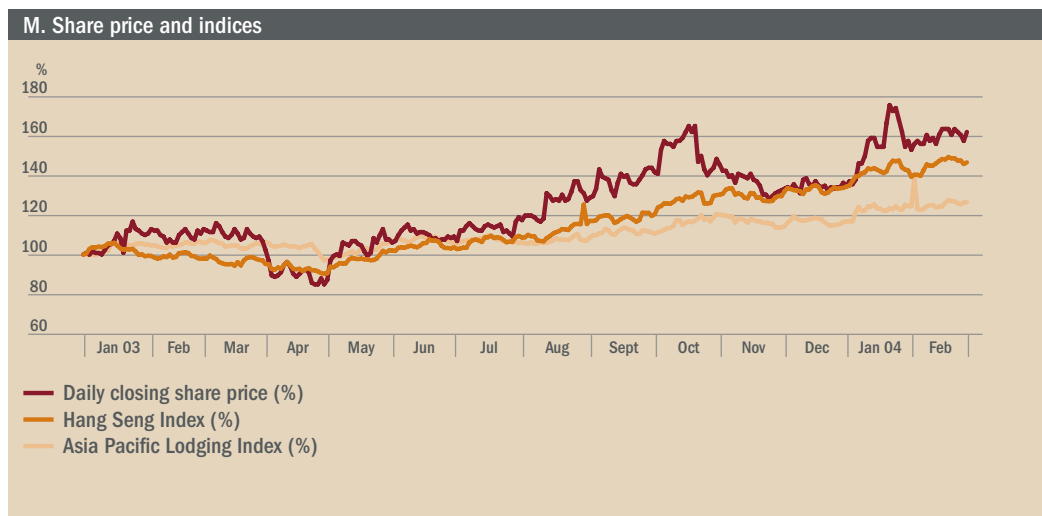
The fair value is calculated as the present value of the expected future cash flows relating to the financial instruments based on the market forward rates at 31 December 2003. In line with the group's accounting policies, the changes in fair value of the off-balance sheet financial instruments are not dealt with in the financial statements as the instruments are not held for speculative purposes.

The following ranges of fixed rates are locked in by interest rate and/or currency swaps as at 31 December 2003:

| | |
|--------------|--------------|
| HK\$ | 4.8% to 7.5% |
| US\$ | 4.6% to 6.0% |
| Thai Baht | 3.1% |
| Japanese Yen | 1.5% to 2.1% |

Share information

The company's share price closed on 26 February 2004 at HK\$5.35 giving a market capitalisation of HK\$7.5 billion (US\$962 million) and reflecting a discount to net asset value of 44%. During 2003, the share price outperformed the Hang Seng Index and an index of leading Asia Pacific hotel stocks.



Note: The share price and indices as at 31 December 2002 = 100%