CHIEF EXECUTIVE OFFICER'S REPORT

2005 was a productive and rewarding year for the company, during which our commitment to quality and service standards resulted in strong growth in business performance and earnings, particularly in our hotel businesses. These operating results, together with several well-executed corporate transactions, the most notable of which was the sale of The Kowloon Hotel, have placed the company in its strongest financial position for some time, with a healthy level of operational earnings and a prudent balance sheet.

HOTELS

Although the group has a relatively small number of hotels with a total of seven Peninsulas worldwide, it has established an enviable international brand name through the quality of its physical product and its commitment to service excellence. All the Peninsula hotels are either the leader or amongst the leaders in room rate and revenue per available room (RevPAR) in their respective cities and this has enabled our group to capture a strong share of the growth in revenue brought about by the favourable market conditions in 2005.

In North America, the three Peninsula hotels continue to be recognised as market leaders and have enjoyed a significant increase in average room rates. The Peninsula New York increased its RevPAR by 16% to HK$3,655, The Peninsula Beverly Hills by 11% to HK$3,395 and The Peninsula Chicago by 17% to HK$2,087.

Our flagship hotel, The Peninsula Hong Kong, enjoyed sustained demand with an occupancy of 79%, thus increasing its RevPAR by 11% to HK$2,271. The Peninsula Palace in Beijing continues to benefit from its recent full renovation and increased its RevPAR by 40% to HK$874. These two hotels have both established retail arcades that continue to be sought after by high-end retail brands. To meet demand from key tenants for additional space at these arcades, we have reconfigured the layout where possible, including creating the first duplex stores at The Peninsula Hong Kong. In 2005, these arcades achieved 96% occupancy at an average rent of HK$268 per square foot per month in Hong Kong and 100% occupancy at HK$80 per square foot in Beijing.

Elsewhere in Asia, the market conditions were less certain. Nevertheless, The

Peninsula Manila achieved a pleasing RevPAR growth of 17% to HK$493 and The Peninsula Bangkok was able to grow its RevPAR by 5% to HK$935.

With the growth in business levels, it has been a challenge to manage costs while maintaining and improving the level of service provided to guests. It is therefore pleasing that we have been able to control our operating costs, as a result of which the EBITDA margin on our hotel businesses has increased from 26% last year to 29% in 2005. At the same time, our hotels continued to gain recognition as being amongst the best in the world, receiving many of the industry's top awards and accolades.

To enhance our marketing and distribution channels and given the expanding size of our group, the decision was made during the year to end our association with Leading Hotels of the World and to establish our own global distribution system under the Peninsula "PN" code. This was effected in December 2005 and has so far operated successfully.

All of our hotels are focussed on enhancing the facilities offered and making the best use of all available space. Enhancement projects completed in 2005 include the final four floors of guest room renovations in Beijing, the expansion of the *Shanghai Terrace* restaurant in Chicago and the enlargement of the spa at Beverly Hills. Newly launched and ongoing projects include the creation of new spas in Hong Kong and Bangkok, the creation of further meeting rooms and enlargement of the spa in Chicago, and the renovation of one of the guestroom wings, as well as public areas, in Manila.

The only hotel property which has not performed satisfactorily in 2005 is Quail Lodge, which has struggled to establish a clear market position following its renovation carried out in 2003, although its RevPAR increased by 13% to HK$1,393 in 2005. We have decided to resume direct management of this property from 1 April 2006, bringing to an end a period under which this Lodge was managed by a joint venture resort management company.

Overall, the hotel division's revenue and EBITDA for the year were HK$2,662 million and HK$769 million, an increase of 5% and 16% respectively as compared to 2004. If the figures for The Kowloon Hotel, which was sold in February 2005, are excluded from this comparison, the increase in revenue and EBITDA would be 19% and 33%.

NON-HOTEL PROPERTIES AND OTHER BUSINESSES

The bulk of our non-hotel properties are situated in Hong Kong, which has enjoyed a strong rebound in both the residential and office lettings markets in 2005 with a further influx of international companies establishing or increasing their presence in the city. Furthermore, the completion of the latest phase of apartment renovations at The Repulse Bay meant that as from September 2005, we had a full inventory of apartments available for letting. Of the 141 apartments at 109 Repulse Bay Road, 99 have now been renovated.

Although there will be some lag in the impact on our revenue due to the timing of lease renewals, the average occupancy and rental per net square foot of the unfurnished apartments at The Repulse Bay increased to 86% and HK$28 per square foot per month respectively, as compared to 78% and HK$25 per square foot in 2004. The serviced apartments were affected by the need to house apartment tenants during the renovation programme and the yield dropped from HK$24 to HK$21 per square foot per month for the year. St John's Building remained steady with occupancy of 90% at HK$15 per square foot per month.

Patronage of the Peak Tram held up well despite the closure of The Peak Tower for most of the year due to its renovation. This renovation has progressed steadily towards its planned completion in the summer of 2006 and we are very much looking forward to launching the re-designed Peak Tower which will have a new and exciting array of shops and restaurants as well as a stunning observation deck at the top of the bowl.

Our other non-hotel operations, including the Thai Country Club, The Landmark complex in Vietnam and our club and airport lounge management operations, have continued to perform well.

With The Peak Tower being closed for most of 2005, revenue and EBITDA from non-hotel properties were relatively flat compared to the previous year, at HK$374 million and HK$263 million respectively. Revenue of our other businesses increased to HK$233 million and EBITDA decreased to HK$60 million.

FINANCE AND RESULTS

This is the first set of annual results to be published by the company following the adoption of a number of new or revised Hong Kong accounting standards with effect from 1 January 2005. The comparatives for 2004 have been adjusted in accordance with these new accounting standards.

It is very pleasing that the company's net profit before non-operating items increased by 39% to HK$688 million in 2005. It should be noted that this figure is stated after additional depreciation of approximately HK$142 million resulting from our hotels now being accounted for on a cost less depreciation basis, rather than previously at open market value. There were a number of non-operating items for the year, most notably the gain of HK$1,171 million from the sale of The Kowloon Hotel and the increase in fair value of investment properties of HK$1,089 million (2004 *restated*: HK$2,812 million). After taking account of the non-operating items, the profit attributable to shareholders for the year was HK$2,664 million (2004 *restated*: HK$2,786 million), equivalent to earnings per share of HK$1.89 (2004 *restated*: HK$1.99).

Our net asset value has increased significantly to HK$14,896 million (2004 *restated*: HK$12,342 million), equivalent to HK$10.51 per share (2004 *restated*: HK$8.80 per share). It should be noted that, under our new accounting policies, this net asset value figure does not include any revaluation of our hotel properties (which as at 31 December 2004 amounted to HK$1,394 million) and has been arrived at after making a provision of HK$2,295 million in respect of deferred taxation on the revaluation surplus on investment properties. The directors do not believe that deferred tax will be payable in respect of Hong Kong properties, as capital gains on such properties are not taxable in Hong Kong.

With the proceeds received from the sale of The Kowloon Hotel and the company's retained earnings, net borrowings had fallen to HK$2,313 million by the year-end, giving rise to a very comfortable net gearing ratio of 13% (2004: 26%).

DEVELOPMENT AND PROJECTS

Our philosophy is based on the long-term ownership and management of top quality hotels and other properties. We believe that by seeking prime locations and then committing significant human and financial resources to creating exceptional hotels, value will be created for our shareholders through both operating results and long-term asset value appreciation, as has been shown by several of our existing properties. This strategy means that we will focus our resources on a limited number of new hotel developments at any one time, as exemplified by the current projects in Tokyo and Shanghai. Both of these projects are situated in exceptional locations. The Peninsula Tokyo is being built in the prestigious Marunouchi area, with the front of the hotel overlooking the Imperial Palace gardens in the centre of Tokyo. The Peninsula Shanghai will be the only new-build fronting the Bund, standing alongside the famous conserved buildings on this iconic promenade.

During the year, satisfactory progress has been made on both of these projects. In Tokyo, the hotel shell and core is under construction with topping out expected in the middle of 2006. The interior designs have been completed and the fit-out contract has been finalised in accordance with the schedule for the opening of the hotel in late 2007. In Shanghai, completion of the land purchase took place in August 2005 and agreement has been reached with the authorities on the key planning parameters of our architectural scheme. We are in the process of progressing our designs and seeking approvals from the authorities in order to commence construction hopefully before the end of 2006 for completion in 2009.

Whilst our development emphasis has been on management and delivery of the Tokyo and Shanghai projects, we have also continued to seek other opportunities for new hotel developments. However, we are selective in our choice of projects and expect to commit to new projects on a measured basis.

In recent years, we have repeatedly emphasised seeking ways to enhance the value of our existing assets through new concepts and redevelopments. The many ongoing enhancement projects at our hotels and properties and in particular the renovation of The Peak Tower are examples of these initiatives. We are also seeking to add value to our investment in The Peninsula Manila through the renovation project which we have initiated. Other prospective enhancement projects are currently under review.

STRATEGY AND OUTLOOK

The way in which our hotels and other properties have been able to capture market share and benefit from the economic recovery in our key locations in the past 2-3 years has reinforced our strategy based on:

1. building our brand qualities and image;
2. enhancing service delivery through staff training, development and empowerment;
3. focussing on prime locations, asset quality and design and build standards; and
4. enhancing the value and functionality of all space within our existing assets.

We believe that the new hotel development projects and the enhancement projects on existing properties currently in progress will provide good longer-term growth prospects for the group. In addition, there continues to be potential for increasing market share at several of our properties which were either recently opened or renovated.

The current outlook for 2006 is positive, with most of our hotels experiencing improved RevPAR as compared to the start of 2005, as well as strong forward bookings on hand. Demand for our Hong Kong properties, particularly on the residential side, remains strong and we look forward to the possibility of increasing rentals upon the expiry of current lease terms. The way in which we have re-positioned the layout of our retail malls in the Peninsulas in Hong Kong and Beijing has sustained strong demand from the high-end retail brands.

Of course, the hospitality industry remains susceptible to unforeseen events which could have a major impact on global travel, the latest threat being a possible widespread outbreak of avian flu. We believe we have the experience and the contingency plans in place to react to such circumstances and mitigate the effects. Fundamentally, however, our industry is both cyclical and not immune to such short term shocks.

Ultimately, our biggest strength is our genuine commitment to the long-term, through investing in our assets and our people and in adhering to the beliefs and values which have been proven through the long history of our company. At the core of this is our commitment to our staff and it is fitting that I should end this message with my thanks and tribute to all the members of the Peninsula "family" who have worked so hard, with flair as well as loyalty, to achieve the results which I am able to report this year.

Clement K M Kwok
16 March 2006