# FINANCIAL REVIEW

Significant changes in accounting policies have impacted the presentation of the group's accounts this year. Whilst the changes made in compliance with the newly adopted accounting policies have had a significant impact on our earnings and assets, the directors believe the underlying fundamentals of the business remain unaltered.

The first significant change to be aware of is that hotel properties (other than shopping arcades and offices at hotels) and golf courses are stated at cost less depreciation and any provision for impairment, rather than at fair market value as previously stated. As at 31 December 2004, these assets were carried in the balance sheet at a fair market value of HK$7,160 million whereas upon restatement, this figure became HK$4,291 million under the cost less depreciation model.

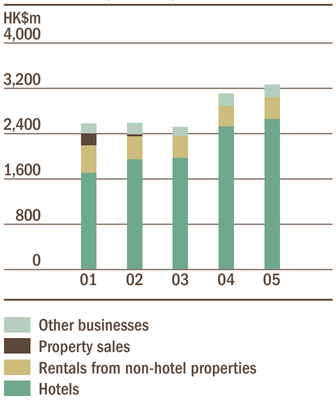
Secondly, whilst investment properties continue to be carried at fair value, any revaluation surpluses or deficits are now reflected in the group's income statement, leading to significant, non-operating volatility in the group's earnings. Furthermore, there is now a requirement to make provision, at the profits tax rate, for deferred taxation in respect of such revaluation surpluses in the group's balance sheet. As at 31 December 2005, the amount of such deferred tax provision was HK$2,295 million, of which HK$2,177 million related to Hong Kong investment properties. It is the directors' position that the group's investment properties are held for the long term and that if any Hong Kong investment properties were sold, tax would not be payable on the disposal at that time as the gain would be capital in nature. Such capital gains are subject to a nil tax rate in Hong Kong.

Finally, as outlined above, depreciation must now be recognised against the group's hotel assets despite the policy of the group to continually maintain and refurbish such assets. This has led to an additional charge for the year of HK$142 million.

The above changes in accounting policies have resulted in the net assets as at 31 December 2004 attributable to the company's shareholders being restated to HK$12.3 billion (HK$8.80 per share) from the previously published figure of HK$17.4 billion (HK$12.40 per share).

The directors wish to draw shareholders' attention to the fact that the changes outlined above have no material effect on the group's EBITDA and operational cash flow, and that the group continues to be managed by reference to the underlying characteristics of the business, irrespective of the accounting rules currently prevailing. In particular, strong emphasis is placed by management on EBITDA and operating profit before non-operating items and on the long-term fair value of the assets in the group's balance sheet.

A. Turnover by activity




## Turnover

The total turnover of the group for the year increased by 5%, as compared to 2004, to HK$3,269 million. Several factors should be taken into account when comparing year-on-year turnover. During 2005, The Kowloon Hotel was sold, resulting in the receipt of one month's income only from this asset. The Peak Tower closed for substantial renovation at the end of April, thus contributing only four months' rental revenue. Finally, The Peninsula Manila became a subsidiary of the company in March 2005, as a result of which its accounts were consolidated for the first time, with the group receiving 10 months' revenue from the property.

The underlying 5% increase in turnover from the hotels was a positive performance. Strong business and leisure traffic in all our markets translated into higher occupancies, room rates and consumption of food and beverage and other hotel services. In Hong Kong, positive consumer sentiment fuelled much higher domestic patronage of the hotel.

With regard to the local property market, which had already begun to recover in 2004, the continued strength of the Hong Kong economy in 2005 contributed to rising demand for office and residential space, and equally led to many high-end retail brands looking for increased space.

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

| HK$m | 2005 | | 2004 | |
|---|---|---|---|---|
| Hotels | | | | |
| Rooms | **1,297** | **40%** | 1,191 | 38% |
| Food and beverage | **735** | **22%** | 715 | 23% |
| Commercial rentals | **377** | **12%** | 382 | 12% |
| Others | **253** | **8%** | 236 | 8% |
| | **2,662** | **82%** | 2,524 | 81% |
| Rentals from non-hotel properties | | | | |
| Residential | **295** | **9%** | 272 | 9% |
| Office | **36** | **1%** | 34 | 1% |
| Shopping arcades | **43** | **1%** | 58 | 2% |
| | **374** | **11%** | 364 | 12% |
| Other businesses | **233** | **7%** | 224 | 7% |
| | **3,269** | **100%** | 3,112 | 100% |
| Arising in | | | | |
| Hong Kong | **1,411** | **43%** | 1,566 | 50% |
| Other Asia | **775** | **24%** | 567 | 18% |
| United States of America | **1,083** | **33%** | 979 | 32% |

***Hotels*** During 2005, our majority-owned hotels ("owned hotels") generated total room revenue of HK$1,297 million compared to HK$1,191 million in 2004. Food and beverage revenues rose 3% year on year, while commercial rental revenues showed a slight decrease – partly as a result of one floor of office space in The Peninsula Tower being taken out of the inventory to be converted to spa facilities.

The properties in Asia have enjoyed healthy business as the volumes of leisure and business travellers have risen markedly. The Peninsula Hong Kong has had a record year in occupancy levels, and its average room rate has gained by 8% year-on-year. In a more challenging environment, The Peninsula Bangkok has improved its room rates, although occupancy has fallen slightly, whilst The Peninsula Palace Beijing has achieved significantly better rates on higher occupancy. There has been a 13% rise in occupancy at The Peninsula Manila which has also seen some rate growth.

In the USA, all the Peninsulas outperformed budget. As demand outstripped supply in the city, The Peninsula New York maintained its high occupancy levels but at substantially higher room rates, up 18% over 2004. The Peninsula Beverly Hills continues to lead its market in RevPAR, maintaining high occupancy and achieving record room rates. The Peninsula Chicago's rates show an upward trend on steady occupancy, and the hotel now leads its competitive set in RevPAR, although rate cutting by its competitors remains a challenge. Whilst Quail Lodge has improved its occupancy and maintained rates, its performance has not yet met expectations. The company will resume direct management of the resort in 2006 and will initiate new marketing efforts for the property at that time.

Revenues from the hotels' shopping arcades have also grown. The rebound in consumer spending, fed by higher earning power and more disposable income, has fuelled demand for premises in prime retail areas. This has manifested itself in a drive by existing tenants for increased and prominently positioned space in the shopping arcades in The Peninsula Hong Kong and The Peninsula Palace Beijing, as well as approaches from new, high profile tenants. Whilst not extensive in size, The Peninsula New York's retail space fronting Fifth Avenue attracts stable tenants and high rent.

The breakdown of revenues by property is as follows:

| HK$m | **2005** Room | **2005** F&B | **2005** Commercial rentals | **2005** Other | 2004 Room | 2004 F&B | 2004 Commercial rentals | 2004 Other |
|---|---|---|---|---|---|---|---|---|
| Owned hotels | | | | | | | | |
| The Peninsula Hong Kong | **274** | **267** | **259** | **58** | 222 | 244 | 247 | 55 |
| The Peninsula New York | **319** | **82** | **29** | **64** | 275 | 75 | 27 | 64 |
| The Peninsula Chicago | **258** | **156** | **–** | **55** | 221 | 142 | – | 49 |
| The Peninsula Bangkok | **126** | **66** | **2** | **12** | 121 | 66 | 2 | 13 |
| The Peninsula Palace Beijing | **178** | **70** | **84** | **20** | 132 | 61 | 81 | 16 |
| The Peninsula Manila* | **75** | **54** | **1** | **17** | – | – | – | – |
| The Kowloon Hotel | **18** | **7** | **2** | **1** | 176 | 99 | 25 | 10 |
| Quail Lodge Resort | **49** | **33** | **–** | **7** | 44 | 28 | – | 6 |
| | **1,297** | **735** | **377** | **234** | 1,191 | 715 | 382 | 213 |
| Managed hotels | | | | | | | | |
| The Peninsula Beverly Hills | **242** | **90** | **–** | **42** | 218 | 89 | – | 47 |
| The Peninsula Manila** | **14** | **11** | **–** | **3** | 76 | 58 | 1 | 21 |
| | **256** | **101** | **–** | **45** | 294 | 147 | 1 | 68 |
| | **1,553** | **836** | **377** | **279** | 1,485 | 862 | 383 | 281 |

*Notes:*

* *In 2005, 10 months' revenue from The Peninsula Manila was consolidated in the financial statements of the group, following the acquisition of a majority share in the hotel.*

** *Revenue on managed hotels is not consolidated in the financial statements of the group. However, management and marketing fees of HK$19 million (2004: HK$23 million) were received from these hotels (2 months pro rata from The Peninsula Manila).*

***Rentals from non-hotel properties*** Total rental revenue from non-hotel properties was HK$374 million, compared to HK$364 million in 2004. With renovation of the unfurnished apartments at 109 Repulse Bay Road completed, a new cycle of rental reversions in progress and prospective tenants seeking space, the full impact of the higher rates and increased occupancy on revenues will not be felt until the second half of 2006.

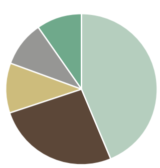
| HK$m | **2005** Residential | **2005** Office | **2005** Shopping arcade | 2004 Residential | 2004 Office | 2004 Shopping arcade |
|---|---|---|---|---|---|---|
| The Repulse Bay complex, Hong Kong | **284** | **–** | **36** | 261 | – | 35 |
| The Peak Tower, Hong Kong | **–** | **–** | **7** | – | – | 23 |
| St John's Building, Hong Kong | **–** | **18** | **–** | – | 17 | – |
| The Landmark, Ho Chi Minh City | **11** | **18** | **–** | 11 | 17 | – |
| | **295** | **36** | **43** | 272 | 34 | 58 |

Commercial revenues dropped as a result of the closure at the end of April of The Peak Tower with the consequent loss of eight months' revenue. At the time of closing, the Tower had 100% occupancy. The renovation will add some 30% more retail space and, with a different market mix, is expected to be able to attract higher rates.

Occupancy and rates at St John's Building benefitted from greater demand from the corporate sector even as available inventory in Central district became scarcer. Rental revenue from the building increased by 6% year-on-year on slightly improved occupancy. Occupancy of the office and residential space in The Landmark remained high and rates held firm, with those of the office sector edging up.

***Other businesses*** Revenue from the Thai Country Club was slightly behind that of 2004, as a number of the greens were closed for re-grassing during the year. Income from the Peak Tram slightly decreased also, as a consequence of the work surrounding the renovation of The Peak Tower, whilst the Peak Entertainment was closed at the end of 2004, also as a result of the redevelopment of The Peak Tower. Income from the restaurants at The Repulse Bay has held steady as has that of Peninsula Clubs and Consultancy Services. Peninsula Merchandising Limited, a wholly owned subsidiary of the group, has had a good year, increasing revenue derived from Peninsula Boutiques in the hotels and franchised operations in department stores and an airport by 55% to HK$17 million. Throughout the year it has opened new outlets in Japan, Taiwan and Thailand and has begun an online service for customers in Hong Kong.

**B. Operating costs (%)**



| | |
|---|---|
| Staff costs and related expenses | 42 |
| Others | 27 |
| Rent and utilities | 11 |
| Cost of inventories | 10 |
| Depreciation & amortisation | 10 |

### Operating costs

An analysis of the operating costs of HK$2,422 million is set out in chart B at left. These are fractionally higher than those of 2004 as result of higher payroll, inventory costs and rent and utilities. The overall decrease in hotel staff numbers is mainly attributable to the sale of The Kowloon Hotel and a reduction in staff numbers at The Peninsula Manila. If not for the payments to The Peninsula Manila's staff under a voluntary early retirement scheme, payroll costs for the group would have been marginally reduced. The closure of The Peak Tower for renovation further reduced the headcount.

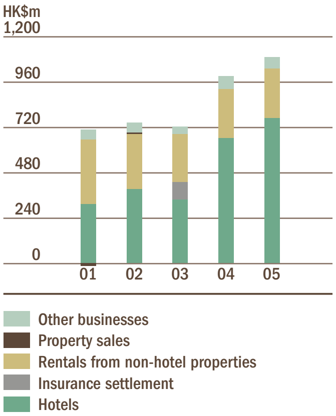
HK$1,028 million or 42% of direct operating costs are payroll-related. This proportion is slightly higher than that of the previous year. The breakdown of employee numbers at 31 December was as follows:

| | 2005 | | | 2004 |
|---|---|---|---|---|
| | **Direct** | **Managed** | **Total** | Total |
| Hotels | **3,919** | **415** | **4,334** | 4,814 |
| Property | **307** | **–** | **307** | 297 |
| Other businesses | **377** | **604** | **981** | 955 |
| | **4,603** | **1,019** | **5,622** | 6,066 |
| Hong Kong | **1,334** | **604** | **1,938** | 2,286 |
| Other Asia | **2,316** | **–** | **2,316** | 2,412 |
| United States of America | **953** | **415** | **1,368** | 1,368 |
| | **4,603** | **1,019** | **5,622** | 6,066 |

### Depreciation

As highlighted above, depreciation during the year was HK$238 million (2004 *restated*: HK$240 million). Such depreciation charge largely relates to hotel properties outlined above.

**C. EBITDA by activity**




### EBITDA

EBITDA (earnings before interest, taxation, depreciation and amortisation) rose by 10% to HK$1,092 million. The increase is attributable mainly to the improvement in the contribution from the hotel division. After adjusting for the results of The Kowloon Hotel which has been sold, EBITDA would have risen by 20%.

EBITDA can be analysed as follows:

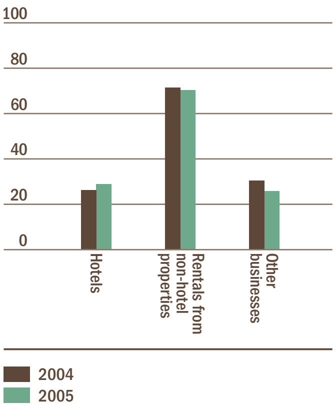
| HK$m | Hong Kong | Other Asia | United States of America | Total |
|---|---|---|---|---|
| **2005** | | | | |
| Hotels | **389** | **240** | **140** | **769** |
| Rentals from non-hotel properties | **246** | **17** | **–** | **263** |
| Other businesses | **51** | **13** | **(4)** | **60** |
| | **686** | **270** | **136** | **1,092** |
| 2004 | | | | |
| Hotels | 411 | 199 | 54 | 664 |
| Rentals from non-hotel properties | 244 | 16 | – | 260 |
| Other businesses | 57 | 13 | (2) | 68 |
| | 712 | 228 | 52 | 992 |

***Hotels*** The hotel division performed strongly as consumer and corporate business volumes remained healthy in all markets. EBITDA for this division increased by 16% to HK$769 million. The Peninsula Hong Kong markedly improved its contribution. The Peninsula Palace Beijing reaped the benefit of its repositioning and renovation, whilst the other Asian properties also improved. The Peninsula New York and The Peninsula Chicago have both enjoyed impressive levels of business with contributions nearly doubling in each case. The only loss, at Quail Lodge Resort, was reduced compared to the previous year, although there is still room for further improvement in this property's performance.

***Rentals from non-hotel properties*** EBITDA arising from rentals in non-hotel properties increased by 1% to HK$263 million. Mitigating the effect of the closure of The Peak Tower for renovation, EBITDA at The Repulse Bay rose by 10%, as the renovated unfurnished apartments commanded higher rates, and demand from the corporate sector increased. St John's Building was steady while The Landmark raised its EBITDA by 6% in a competitive market.

***Other businesses*** EBITDA from other businesses decreased by 12% to HK$60 million compared to HK$68 million in 2004. The Peak Tram was affected by the renovation of The Peak Tower and there was no contribution from Peak Entertainment following its closure at the end of 2004. Peninsula Merchandising held steady whilst contributions from all other operations in this division dropped.

D. EBITDA margin (%)



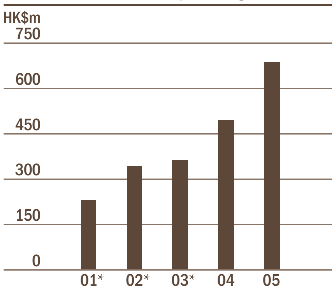

## EBITDA margin

EBITDA margin represents EBITDA as a percentage of turnover and is analysed as follows:

| | 2005 | 2004 *(restated)* |
|---|---|---|
| Hotels | **29%** | 26% |
| Rentals from non-hotel properties | **70%** | 71% |
| Other businesses | **26%** | 30% |
| Overall EBITDA margin | **33%** | 32% |
| Arising in Hong Kong | **49%** | 45% |
| Other Asia | **35%** | 40% |
| United States of America | **13%** | 5% |

Most hotels improved their margins in 2005, but the overall effect was diluted by the voluntary retirement payout to staff at The Peninsula Manila, whilst this property was not included in the 2004 comparative figures. If not for this, EBITDA margin would have risen to 30% for hotels and 34% overall. The closure of The Peak Tower for eight months led to a small decrease in the overall margin on non-hotel properties, although the effect was mitigated by the strong performance of The Repulse Bay. The margin on other businesses was depressed chiefly as a result of the closure of Peak Entertainment at the end of 2004 and lower revenues at the Peak Tram, both as a result of the renovation of The Peak Tower, and the loss of profit from the Thai Country Club whilst re-grassing of the greens was underway.

E. Profit before non-operating items




* Figures for years 01 to 03 have not been restated in respect of the new accounting policies

## Profit before non-operating items

The strong performance of the business during the year was reflected in significantly improved profit before non-operating items of HK$688 million, up 39% as compared to 2004. This is one of the key measures on which management focusses, as it believes this more properly reflects the underlying performance of the business. As discussed above, this performance was driven in particular by the continuing strength of the group's hotel properties whilst a number of the group's non-hotel assets were at various stages of renovation.

## Non-operating items

There were a number of non-operating items during the year which are summarised as follows:

| HK$m | | 2005 | 2004 |
|---|---|---|---|
| Gain on disposal | – The Kowloon Hotel | **1,171** | - |
| | – Phuket land | **60** | - |
| Fair value adjustments | – investment properties | **1,089** | 2,812 |
| | – hotel & other properties | **117** | 91 |
| | – financial instruments (in relation to the disposal of The Kowloon Hotel) | **(218)** | - |
| Others | | **22** | (12) |
| | | **2,241** | 2,891 |

On 1 February 2005, the group completed the sale of The Kowloon Hotel Limited (TKHL) which held The Kowloon Hotel for HK$1.9 billion, in order to focus its resources on developing and marketing the Peninsula brand. A non-operating gain of HK$1.2 billion was recognised, being the difference between the sale proceeds net of related expenses of HK$1.9 billion and the net asset value of TKHL at completion, which was restated at HK$0.7 billion, excluding assigned intercompany debts. Revenue, EBITDA and operating profit generated from TKHL for the pre-completion period in January 2005, amounting to HK$28 million, HK$14 million and HK$13 million respectively, have been included in the income statement.

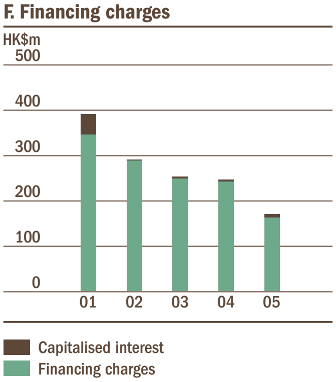
On 15 December 2005, the group disposed of land in Phuket, Thailand for a cash consideration of approximately HK$163 million, thereby recognising a gain of HK$60 million. The land was never developed and had been vacant since the group acquired it.

With effect from 1 January, 2005, following the adoption of new accounting standards, fair value changes of investment properties and financial instruments, that are neither long-term equity investments nor derivatives qualifying for hedge accounting, are recorded in the income statement. Also, the group continues to assess the recoverable value of its hotel and other properties which are now stated on a cost less depreciation model to determine whether there is any provision required for asset impairment or reversal of asset impairment previously made. These fair value adjustments are classified as non-operating items.

As a result of the increase in value of the group's investment properties in almost all regions (see pages 61 and 62), fair value gains totalling HK$1,089 million were recognised in the 2005 income statement. This strong investment property market background together with the performance of the hotel business, also led to a reversal of impairment losses in hotel assets, although the directors also felt it was necessary to make an impairment provision in respect of Quail Lodge whose performance continues to be disappointing. A net amount of HK$117 million of impairment losses previously made on fixed assets was reversed in 2005.

A net fair value loss of HK$218 million in respect of financial instruments was recorded in the income statement. This net loss arose from an offsetting swap arrangement in relation to the disposal of The Kowloon Hotel, which resulted in an allocation of the fair value of ineffective interest rate swaps being offset from the hedging reserve to the income statement without any adjustment to net assets.

**F. Financing charges**




## Financing charges

Financing charges on borrowings in 2005 amounted to HK$171 million. Of this, HK$8 million was capitalised in respect of projects under development, leaving a net charge of approximately HK$163 million to the income statement. Following the disposal of The Kowloon Hotel and land in Phuket (see above), the group's debt was reduced, and net financing charges were 33% lower than 2004.

The weighted average gross interest rate for the year remained at 5.0% (2004: 5.0%). Interest cover has improved, with operating profit at 5.2 times (2004 *restated*: 3.1 times) net financing charges for the year.

### Taxation

The taxation charge for the year increased compared to 2004 mainly due to the increase in operating profit of the group. The positive outlook for the group's businesses also led to the recognition of deferred tax assets previously not accounted for totalling HK$110 million, in respect of unutilised tax losses of certain subsidiaries that are likely to be utilised in future years.

Deferred tax liabilities with respect to accumulated valuation surpluses on investment properties increased to HK$2.3 billion (2004 *restated*: HK$2.1 billion), thereby resulting in a deferred tax expense of HK$0.2 billion. Including this item, the total tax expenses for non-operating items for the year amounted to HK$173 million (2004 *restated*: HK$480 million).

The details of the taxation charge are as follows:

| HK$m | **2005** | 2004 |
|---|---|---|
| Taxation on operating profit for the year | **145** | 93 |
| Recognition of prior years' tax losses | **(110)** | – |
| Taxation on operating items | **35** | 93 |
| Taxation on non-operating items | **173** | 480 |
| Taxation in the income statement | **208** | 573 |

## BALANCE SHEET

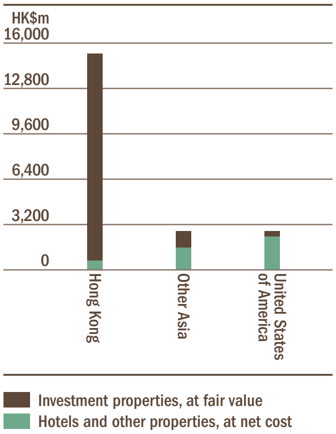
### Non-current assets

The group owns and manages eight hotels in Asia and the United States of America, and is developing two more hotels in Tokyo and Shanghai.

In addition to hotel investments, the group owns residential apartments, office towers and shopping arcades for rental purposes.

As highlighted earlier, following the adoption of new accounting standards from 1 January 2005, hotel properties (other than shopping arcades and offices at hotels) and golf courses are stated at cost less accumulated depreciation and any provision for impairment, whilst investment properties continue to be stated at fair value.

G. Valuation




A summary of hotel and other properties which are stated at cost less depreciation and impairment (“net cost”) as at 31 December 2005 is listed as follows:

| | Total Property GFA (sf) | Net Cost (HK$'m) | HSH Interest (%) | Attributable Amount (HK$'m) |
|---|---|---|---|---|
| **Hotel Properties** | | | | |
| **Owned Hotels** | | | | |
| The Peninsula Hong Kong<br>*Lease Expiry Jan-2072* | 781,499* | 643 | 100% | 643 |
| The Peninsula New York<br>*Lease Expiry Aug-2078* | 305,870* | 572 | 100% | 572 |
| The Peninsula Chicago<br>*Freehold/Leasehold* | 403,219 | 1,063 | 92.50% | 983 |
| The Peninsula Bangkok<br>*Freehold* | 716,466* | 690 | 75% | 518 |
| The Peninsula Palace Beijing<br>*Lease Expiry Nov-2033* | 790,902* | 546 | 42.13% | 230 |
| The Peninsula Manila<br>*Lease Expiry Dec-2027* | 921,203* | 175 | 76.09% | 133 |
| Quail Lodge Resort<br>*Freehold* | 1,664,460 | 176 | 100% | 176 |
| | 5,583,619* | 3,865 | | 3,255 |
| **Managed Hotel** | | | | |
| The Peninsula Beverly Hills | | 473 | 20% | 95 |
| **Total Hotel Properties** | | 4,338 | | 3,350 |
| **Other Properties** | | | | |
| Thai Country Club<br>*Freehold* | 7,405,283 | 172 | 75% | 129 |
| Quail Lodge Golf Club<br>*Freehold/Leasehold* | 5,846,888 | 47 | 100% | 47 |
| Po Yip Building, Flat 2, 1/F<br>*Lease Expiry Jun-2047* | 20,594 | 13 | 100% | 13 |
| 1 Lugard Road<br>*Lease Expiry Jan-2077* | 4,938 | – | 100% | – |
| Sun Hing Industrial Building, Units 1&2, 5/F<br>*Lease Expiry Jul-2120* | 4,694 | – | 100% | – |
| **Total Other Properties** | 13,282,397 | 232 | | 189 |
| **Total Hotel and Other Properties** | 18,866,016 | 4,570 | | 3,539 |

** The hotel property GFA includes the GFA of shopping arcades and/or offices at hotels.*

A summary of investment properties which are carried at fair value as at 31 December 2005 is listed as follows:

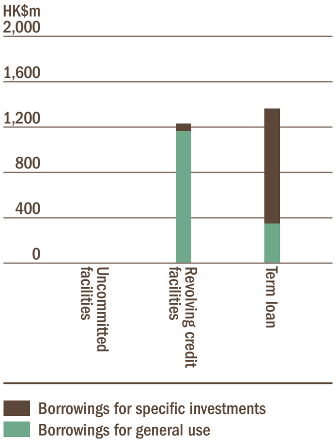
| | Total Property GFA (sf) | Net Lettable Area: Shopping Arcade (sf) | Net Lettable Area: Office (sf) | Net Lettable Area: Residential (sf) | Fair Value (HK$'m) | HSH Interest (%) | Attributable Amount (HK$'m) |
|---|---|---|---|---|---|---|---|
| **Properties for Rental** | | | | | | | |
| **Hotels** | | | | | | | |
| The Peninsula Hong Kong<br>*Lease Expiry Jan-2072* | | 72,535 | 59,866 | – | 5,014 | 100% | 5,014 |
| The Peninsula New York<br>*Lease Expiry Aug-2078* | | 7,574 | – | – | 331 | 100% | 331 |
| The Peninsula Bangkok<br>*Freehold* | | 3,246 | – | – | 21 | 75% | 16 |
| The Peninsula Palace Beijing<br>*Lease Expiry Nov-2033* | | 77,680 | – | – | 769 | 42.13% | 324 |
| The Peninsula Manila<br>*Lease Expiry Dec-2027* | | 10,473 | | | 8 | 76.09% | 6 |
| **Non-hotel Properties** | | | | | | | |
| The Repulse Bay<br>*Lease Expiry May-2068* | 805,990 | 26,012 | – | 376,893 | 5,209 | 100% | 5,209 |
| Repulse Bay Apartments<br>*Lease Expiry Mar-2071* | 710,763 | – | – | 418,692 | 3,429 | 100% | 3,429 |
| Repulse Bay Garage<br>*Lease Expiry Sep-2070* | 36,438 | 16,934 | – | – | 76 | 100% | 76 |
| The Peak Tower (currently under redevelopment)<br>*Lease Expiry Mar-2031* | 116,546 | 49,347 | – | – | 494 | 100% | 494 |
| St John's Building<br>*Lease Expiry Aug-2114* | 103,857 | 635 | 60,690 | – | 366 | 100% | 366 |
| The Landmark<br>*Lease Expiry Jan-2026* | 224,922 | – | 80,439 | 54,821 | 72 | 70% | 50 |
| **Total Properties for Rental** | 1,998,516 | 264,436 | 200,995 | 850,406 | 15,789 | | 15,315 |
| **Vacant Properties** | | | | | | | |
| Vacant land near Bangkok<br>*Freehold* | 15,040,030 | – | – | – | 287 | 75% | 215 |
| Quail Lodge Land<br>*Freehold* | 15,470,337 | – | – | – | 79 | 100% | 79 |
| **Total Vacant Properties** | 30,510,367 | – | – | – | 366 | | 294 |
| **Total Investment Properties** | 32,508,883 | 264,436 | 200,995 | 850,406 | 16,155 | | 15,609 |

Third party valuations of the group's investment properties, including shopping arcades and offices at hotels, were carried out as at 31 December 2005. Unrealised gains or losses arising from the valuations are dealt with in the income statements and are summarised below:

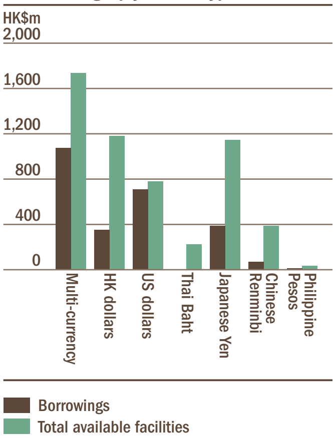
| HK$m | Surpluses or (deficits) | Deferred Taxation | Minority Interests | Net surpluses or deficits |
|---|---|---|---|---|
| Owned hotels | | | | |
| The Peninsula Hong Kong | 539 | (94) | – | 445 |
| The Peninsula New York | 32 | (13) | – | 19 |
| The Peninsula Chicago* | – | – | – | – |
| The Peninsula Bangkok | 1 | – | – | 1 |
| The Peninsula Palace Beijing | 13 | (4) | – | 9 |
| The Peninsula Manila | – | – | – | – |
| Quail Lodge Resort* | – | – | – | – |
| | 585 | (111) | – | 474 |
| Non-hotel properties | | | | |
| The Repulse Bay complex | 396 | (69) | – | 327 |
| The Peak Tower | 49 | – | – | 49 |
| St John's Building | 44 | (8) | – | 36 |
| The Landmark | (1) | – | – | (1) |
| Thai Country Club* | – | – | – | – |
| Quail Lodge land | 10 | (3) | – | 7 |
| Vacant land near Bangkok | 6 | (2) | (1) | 3 |
| | 504 | (82) | (1) | 421 |
| Total valuation surpluses recognised in 2005 | 1,089 | (193) | (1) | 895 |
| Unrealised gains at 1 January 2005 *(restated)* | | | | 9,442 |
| Realisation on disposal of The Kowloon Hotel | | | | (199) |
| Realisation on disposal of Phuket land | | | | 38 |
| Exchange differences | | | | 3 |
| Unrealised gains at 31 December 2005 | | | | 10,179 |

** There are no investment properties inside these properties.*

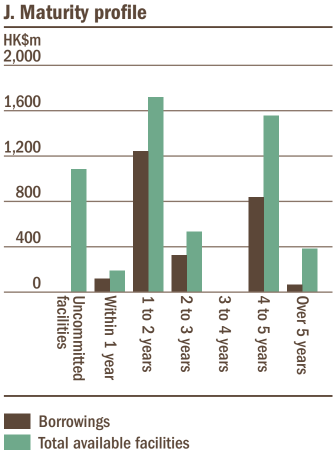
**H. Borrowings (by type)**




**I. Borrowings (by currency)**




**J. Maturity profile**




## Borrowings

Borrowings decreased significantly during the year mainly as a result of the application of the proceeds from the sale of The Kowloon Hotel. Gearing, expressed as the percentage of net borrowings to the total of net borrowings and net assets, decreased significantly to 13% (2004 *restated*: 26%), which 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, such as The Peninsula Chicago, The Peninsula Bangkok, The Peninsula Palace Beijing, The Peninsula Manila and The Peninsula Tokyo.

In addition to the borrowings of the group, The Peninsula Beverly Hills (20%-owned) obtains non-recourse bank borrowings, which are not consolidated in the balance sheet as the entity owning the hotel is not a subsidiary of the company. Consolidated and non-consolidated borrowings at 31 December 2005 are summarised as follows:

| | **2005** | | | | 2004 *(restated)* |
|---|---|---|---|---|---|
| HK$m | **Hong Kong** | **Other Asia** | **United States of America** | **Total** | Total |
| Consolidated borrowings | | | | | |
| For general use | **1,441** | **10** | **84** | **1,535** | 3,342 |
| For specific investments | **–** | **455** | **624** | **1,079** | 1,194 |
| Consolidated borrowings | **1,441** | **465** | **708** | **2,614** | 4,536 |
| Off balance sheet borrowings attributable to the group, for specific investment | | | | | |
| The Peninsula Manila | **–** | **–** | **–** | **–** | 4 |
| The Peninsula Beverly Hills | **–** | **–** | **119** | **119** | 121 |
| Off balance sheet borrowings | **–** | | **119** | **119** | 125 |
| Consolidated and non-consolidated borrowings | **1,441** | **465** | **827** | **2,733** | 4,661 |
| Pledged assets attributable to the group | | | | | |
| For consolidated borrowings | **–** | **1,315** | **–** | **1,315** | 1,257 |
| For off balance sheet borrowings | **–** | **–** | **269** | **269** | 271 |
| | **–** | **1,315** | **269** | **1,584** | 1,528 |

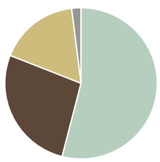
Borrowing requirements are not seasonal as the group benefits from a steady inflow of income from its investment properties and there is only modest seasonality in its hotel operations. Borrowing requirements tend to follow the pattern of capital expenditure and investment at the properties.

**Derivative financial instruments**
With the adoption of the new accounting standards, derivative financial assets and liabilities are recorded at their fair value.

The favourable change in fair value of derivative financial instruments in 2005 resulted in a decrease of net liabilities in respect of these instruments.

## LIQUIDITY

**K. Capital expenditure (%)**



| | |
|---|---|
| New project development – Tokyo & Shanghai | 54 |
| Major renovations | 27 |
| Other capital expenditure | 17 |
| Additional investment – Manila | 2 |

Net cash generated from operating activities amounted to HK$1,058 million as compared to HK$992 million in 2004. Total cash flow was supplemented by the sale of The Kowloon Hotel.

In order to minimise interest costs, bank borrowings totalling HK$1,886 million were prepaid or repaid during the year. Notwithstanding an increase in overall market interest rates, the reduction in borrowings and effective management of interest costs resulted in interest payable falling to HK$210 million compared to HK$248 million in 2004.

Capital expenditure in 2005 totalled HK$664 million and is summarised below:

| HK$m | 2005 | 2004 |
|---|---|---|
| New project development – Tokyo | **52** | 52 |
| – Shanghai | **308** | 133 |
| Cash consideration for additional investment – Manila | **12** | – |
| Major renovations in certain properties | **182** | 79 |
| Capital expenditure at other existing properties | **110** | 96 |
| | **664** | 360 |

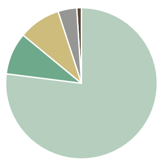
The group spent HK$360 million on new projects, including capital expenditure for The Peninsula Tokyo and equity injection into the joint venture in Shanghai. Construction of The Peninsula Tokyo is progressing on schedule and it is expected that construction of The Peninsula Shanghai will commence in late 2006. Accordingly, the group's capital expenditure in relation to these projects is anticipated to increase significantly in the next three years.

During the year, the group increased its equity stake in Manila Peninsula Hotel, Inc., which is now a subsidiary of the company.

Major renovations included the programmes for The Repulse Bay, The Peak Tower and spa facilities at The Peninsulas Hong Kong and Bangkok. In addition, capital expenditure of HK$110 million was incurred on upkeep and minor capital projects at our existing properties.

## RISK MANAGEMENT

**L. Net assets (%)**



| | |
|---|---|
| HK dollars | 77 |
| US dollars | 9 |
| Chinese Renminbi | 9 |
| Thai Baht | 4 |
| Philippine Pesos | 1 |

The group emphasises risk minimisation and hedges its exposure to financial risks by using various techniques, including derivative financial instruments. In particular, the group minimises its exposure to currency and interest rate risks. The group's risk management policy is summarised in note 33 to the financial statements.

As at 31 December 2005, after accounting for currency hedging, approximately 77%, 9%, 9%, 4%, and 1% of the group's net assets were denominated in Hong Kong dollars, Chinese Renminbi, United States dollars, Thai Baht and Philippine Pesos respectively. In terms of interest rate hedging, the interest rates on 52% (2004: 66%) of the group's borrowings were fixed at 31 December 2005.

## IMPACT OF NEW ACCOUNTING POLICIES

With effect from 1 January 2005, the group has adopted new accounting standards as issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), the details of which are set out in note 2 to the financial statements.

On the income statement, the effects are:

(1) Additional depreciation and amortisation of HK$142 million (2004 *restated*: HK$144 million) was provided for hotel properties, leasehold land on which hotel properties are situated, and golf courses.

(2) Changes in fair value of financial instruments resulted in a loss of HK$218 million (2004: HK$nil, as the adjustment only took effect prospectively from 1 January 2005), arising in respect of those instruments which do not fulfil the hedging requirements as specified in HKAS 39 "Financial Instruments", mainly in connection with the offsetting swap arrangements. This compares to a provision for losses of HK$242 million under the accounting standards previously adopted.

(3) Changes in fair value of investment properties totalling HK$1,089 million (2004 *restated*: HK$2,812 million) were recorded in the income statement, instead of the revaluation reserve. Deferred taxation charges of HK$193 million (2004 *restated*: HK$477 million) arising from these changes were recognised in the income statement. Under previous accounting standards, HK$24 million (2004: HK$11 million) deferred tax charges were recognised in the revaluation reserve, mainly with regard to non-Hong Kong investment properties.

(4) A gain of HK$1.2 billion (2004: HK$nil) was recognised on the disposal of The Kowloon Hotel based on cost accounting for hotel properties. Under the previous accounting policy of carrying hotels at market value, the gain on disposal would have been HK$0.2 billion.

On the balance sheet:

(1) The change of accounting policy from market valuation to cost accounting for hotel properties and the leasehold land on which hotels are situated has resulted in a reduction of approximately HK$3 billion in the carrying value of fixed assets and other non-current assets as at 31 December 2004.

(2) The recognition of deferred taxation arising from revaluation surpluses on Hong Kong investment properties has further reduced the net assets by HK$2 billion at 31 December 2004.

(3) The requirement to fair value financial instruments, including hedging derivatives, has increased net liabilities by HK$0.3 billion as at 1 January 2005.

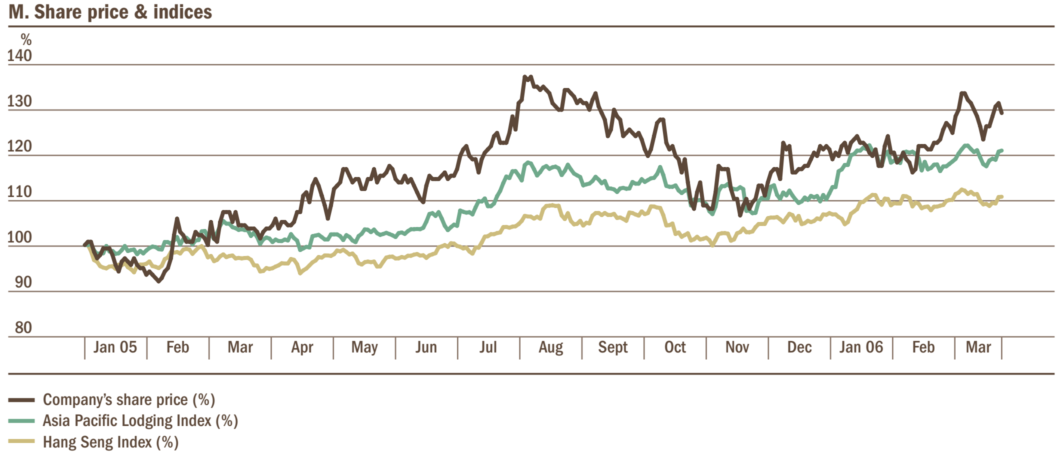
In accordance with the new accounting standards, the balance sheet adjustments in (1) and (2) above were made retrospectively with the comparative figures for 2004 being restated, whilst the adjustment in (3) was made prospectively on 1 January 2005 without a restatement of the comparative figures.

The HKICPA has issued some further amendments to accounting standards, and new standards and interpretations which will be effective subsequent to the financial year ended 31 December 2005. The group has not early adopted these amendments, standards and interpretations, and considers that the adoption will not have any significant impact on the group's results and financial position.

## SHARE INFORMATION

The company's share price closed on 16 March 2006 at HK$8.95 giving a market capitalisation of HK$12.7 billion (US$1.6 billion) and reflecting a discount to net assets which are attributable to equity shareholders of the company of 15%. During 2005, the share price outperformed the Hang Seng Index and an index of leading Asia Pacific hotel stocks.

**M. Share price & indices**




*Note: The share price and Indices as at 31 December 2004 = 100%*