Chief Executive Officer's Report

Our Group has had another excellent year in 2006. Amidst favourable market conditions, our hotels and other properties and businesses benefited from their strong market positions and the strength of our brand to achieve a significant improvement in earnings, with this year's net profit before non-operating items of HK$904 million, representing an increase of 31% from last year.

HSH has now enjoyed a sustained recovery over the past five years since emerging from the Asian financial crisis which began in the late 1990s. The extent of this recovery can be seen from our EBITDA trend, which has improved consistently every year from a low of HK$698 million in 2001 to HK$1,281 million in 2006. The cumulative effect of these years of earnings growth, coupled with a number of successfully executed corporate transactions, is that the Company's financial position has been significantly strengthened, with our gearing level dropping further to 11% at this year-end.

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 top or amongst the leaders in room rate and revenue per available room ("RevPAR") in their respective cities.

We continue to focus on seeking projects to enhance our brand and our services, as well as to boost the return on our hotel assets. One of the main themes that we have been working on is to develop our own exclusive line of Peninsula spas, which we are doing in conjunction with the world-renowned spa operator, ESPA. During the year, the first spa under this new concept was launched with the opening of the magnificent Peninsula Hong Kong spa, and this has since been followed by the opening of the beautiful Peninsula Bangkok spa, which is housed in its own Thai-style building. The existing spas at The Peninsula Chicago and The Peninsula Beverly Hills have also been renovated under this overall initiative.

Another exciting development was the completion of the extensive renovation of The Peninsula Manila, which included all the guestrooms in the Makati Tower, the Lobby, the Ballroom and some back of house areas. Opened in December 2006, the newly renovated rooms are already commanding a substantial premium over the unrenovated rooms in the Ayala Tower.

A number of other improvement projects have been carried out within our hotels, including the rejuvenation of the roof garden restaurant and pool area at The Peninsula Beverly Hills, and a reconfiguration of the meeting rooms at The Peninsula Chicago. We also welcomed the arrival of the new fleet of 14 Rolls Royce Phantoms to The Peninsula Hong Kong.

In terms of business results, The Peninsula Hong Kong benefited from the buoyant conditions in Hong Kong and was able to increase its RevPAR by 14% to HK$2,592 (US$332). The Peninsula Beijing, having completed its name re-branding exercise during the year, increased its RevPAR by 19% to HK$958 (US$123). The Peninsula Manila was disrupted for significant periods during 2006 by the seven-month renovation construction programme, but its RevPAR only decreased by 2% to HK$484 (US$62).

The Peninsula Bangkok, recognised by *Travel & Leisure* magazine as the world's best business hotel, was affected by the coup which ousted the Prime Minister of Thailand in September 2006. Under these circumstances, the hotel has done well to maintain a RevPAR of HK$1,010 (US$129), up 8% from last year.

In North America, the three Peninsula hotels have enjoyed increases in average room rates in the midst of buoyant business conditions. The Peninsula New York increased its RevPAR by 11% to HK$4,066 (US$521), The Peninsula Beverly Hills by 11% to HK$3,772 (US$484) and The Peninsula Chicago by 17% to HK$2,449 (US$314). Amongst the many accolades won by these hotels during the year was recognition of The Peninsula Chicago as the Best Hotel in North America by *Condé Nast Traveler*.

Following the decision to resume direct management of Quail Lodge as from 1 April 2006, our new General Manager, Sarah Cruse, has worked closely with her revamped management team to re-energise and improve Quail Lodge's product quality and business levels. The business result of Quail, after depreciation but before interest, has improved by HK$12 million for 2006 as compared to the previous year. With a difficult set of union negotiations finally successfully concluded in January 2007, we are looking forward to further improvements in 2007.

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 29% last year to 30% in 2006. At the same time, our hotels continued to gain recognition as being amongst the best hotels in the world with awards from *Condé Nast Traveler*, *Travel & Leisure*, *Zagat* and *Business Traveller Asia-Pacific*.

The top brand name retail arcades in The Peninsula Hong Kong and The Peninsula Beijing both continue to enjoy almost full occupancy. We have worked closely with our tenants to seek ways of enhancing their facilities and meeting their needs, such as creating some duplex store spaces in The Peninsula Hong Kong. During the year, these arcades achieved 96% occupancy at an average rent of HK$293 per square foot per month in Hong Kong, and 96% occupancy at HK$85 per square foot per month in Beijing.

Peninsula Merchandising has opened new Peninsula boutiques in Nagoya, Taipei and Hong Kong, bringing the total number of shops to 13. We also opened the first Peninsula Boutique and Café at the Siam Paragon mall in Bangkok.

Overall, the hotel division's revenue and EBITDA for the year were HK$2,950 million and HK$882 million, an increase of 11% and 15% respectively as compared to 2005.

Non-hotel Properties and Operations

The most significant achievement in our property division during the year was the completion of the extensive renovation of The Peak Tower in Hong Kong and its successful re-opening. Through a clever re-design of the interior space, we have been able to add 1,664 square meters (representing an increase of some 30%) of additional lettable space, as well as a lively new atrium and a spectacular new viewing terrace at the top of the Tower. The Peak Tower is now fully let at an average rent per square foot of approximately HK$42, as compared to the average rent of HK$28 per square foot prior to the renovation.

During the year, the market remained buoyant in Hong Kong for both residential and office lettings and this was reflected in the performance of our properties. The average occupancy and rental per square foot of the unfurnished apartments at The Repulse Bay increased to 94% at HK$34 per square foot per month, as compared to 86% at HK$28 per square foot in 2005. St. John's Building improved to an occupancy of 99% at HK$21 per square foot per month.

The Repulse Bay Commercial Arcade remained fully let at an average rental of HK$68 per square foot for the year. This complex has, over the years, provided excellent support services to the residents in The Repulse Bay, as well as being one of Hong Kong's leading wedding venues and a centre for dining and shopping in the south side of Hong Kong Island. Architecturally a replica of the famous old Repulse Bay Hotel, we are now exploring plans to renovate and increase its useable area, in order to further improve its functionality and appeal.

Hong Kong had a record year for tourism and patronage on The Peak Tram grew by 13% to 4.43 million passengers, despite the closure of The Peak Tower for more than half of the year due to its renovation.

Our other non-hotel operations, including the Thai Country Club, The Landmark office and serviced apartment complex in Vietnam and Tai Pan Laundry all performed satisfactorily. We have signed a new agreement with Cathay Pacific Airways for the management of their first and business class lounges at the Hong Kong International Airport which will help us to cater for the continuing increase in demand.

Overall, the revenue and EBITDA from non-hotel properties and operations for the year were HK$773 million and HK$399 million, an increase of 27% and 24% respectively as compared to 2005.

Development and Projects

Our business philosophy is based on the long-term ownership and management of a select number 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. 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, which are both situated in exceptional locations. The Peninsula Tokyo is being built in the prestigious Marunouchi area in central Tokyo, with the front of the hotel offering a panoramic view over the Imperial Palace and its gardens and Hibiya Park. The Peninsula Shanghai will be the only new-build with a frontage directly onto the Bund, standing alongside the famous preserved buildings on this renowned promenade.

The Peninsula Tokyo project has reached a very exciting stage. The building was topped out in mid 2006 and the interior fit-out is now well advanced. The General Manager of the hotel is in place as is his senior management team and the first official press launch took place in September 2006. It is expected that the hotel will be handed over to the operations team this coming summer, for soft opening in the autumn and grand opening before the end of the year.

In Shanghai, we received all of the planning and construction permits in order to break ground and commenced piling works in October 2006. These piling works will be completed in March 2007 and construction of the basement diaphragm walls is underway. Designs of both the exterior building and the interior spaces are well progressed. We continue to work towards a timetable for completion of construction before the end of 2009.

Whilst our 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.

Finance and Results

It is very pleasing that the Company's net profit before non-operating items increased by 31% to HK$904 million in 2006. It should be noted that this figure is stated after total depreciation of approximately HK$246 million (2005: HK$231 million) resulting from our hotels being accounted for on a cost and depreciation basis, rather than at open market value. Regarding non-operating items, it is important to note that there was a one-off gain last year of HK$1,171 million from the sale of The Kowloon Hotel which did not recur this year. Otherwise, the increase in fair value of investment properties was HK$1,442 million compared to HK$1,089 million last year. The decrease in profit attributable to shareholders, from HK$2,664 million last year to HK$2,094 million this year, was therefore entirely attributable to the absence of the one-off gain from the sale of The Kowloon Hotel this year. The earnings per share for the year amounted to HK$1.47 (2005: HK$1.89). We have provided for shareholders' additional information a calculation of our earnings excluding non-operating items, which as set out on page 49, amounts to HK$761 million (2005: HK$641 million), representing earnings per share of HK$0.54 (2005: HK$0.45).

Our net asset value has increased significantly to HK$16,982 million (2005: HK$14,896 million), equivalent to HK$11.89 per share (2005: HK$10.51 per share). Our financial statements are prepared on the basis that our hotels are recorded at cost less depreciation and any impairment provision. It should be noted that in many cases, the current market value of these hotel properties is significantly higher than book value, and we have therefore provided an up-to-date assessment of these market values by independent valuers as at 31 December 2006, as set out in the Financial Review section of this annual report. It should also be noted that the above net asset value figure has been arrived at after making a provision of HK$2,407 million in respect of deferred taxation on the revaluation surplus on Hong Kong investment properties, which the Directors do not believe will materialise as capital gains on such properties are not taxable in Hong Kong. In the light of the above, the Directors have provided for shareholders' additional information a calculation of our adjusted net asset value, on the basis set out in the Financial Review section of this annual report, which amounts to HK$21,841 million (equivalent to HK$15.29 per share).

With the investment property revaluation and the Company's retained earnings, net borrowings had reduced to HK$2,076 million by the year-end, giving rise to a very comfortable net gearing ratio of 11% (2005: 13%).

Total capital expenditure during 2006, including investment in our new development projects in Tokyo and Shanghai, amounted to HK$645 million as compared to cash generated from operations of HK$1,271 million. Our net cash inflow for the year after payment of interest and dividends before financing activities was HK$232 million.

The Directors are recommending to shareholders a final dividend for the year of 11 cents per share. Together with the interim dividend of 5 cents per share already paid, the total dividend for the year will be 16 cents per share, an increase of 14% over last year. Shareholders will continue to have the option to receive their dividends in either scrip or cash.

Strategy and Outlook

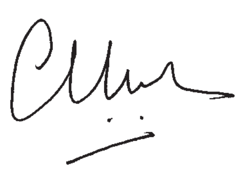
I am delighted that, with the support of our Board and our management team, we have been able to focus on a consistent strategy over the past five years and I believe that it is this focus which has helped to generate the pleasing trend of results which the Company has achieved. Therefore, once again, I am able to report that our strategy remains largely unchanged with an emphasis on:

1. building our brand quality and image,
2. enhancing service delivery through staff training, development and empowerment,
3. focusing 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 currently in progress will enhance the value of the Group in the longer term. In the meantime, we have already seen the positive effects of our ongoing renovation programme, with The Peak Tower renovation and The Peninsula Manila guestrooms renovation in particular giving rise to significant increases in revenue. The next phase of our renovation programme will see further spa developments and a revitalisation plan for The Repulse Bay Arcade.

Present business momentum is good at all of our hotels, although once again the events of the past year have served to remind us of the susceptibility of the hotel industry to unforeseen occurrences such as the military coup in Thailand. On the property side, although demand remains healthy for retail, office and residential property in Hong Kong, we may well see a slowdown in the surge in demand and the focus will be on working closely with our tenants to ensure that we can continue to offer an attractive product that meets their needs.

Ultimately, the biggest protection we have against the ups and downs of the businesses we operate in 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
15 March 2007