Key components of the financial statements

The objective of the financial statements is to set out the historic financial performance and financial position of the Group. The key components of the financial statements are the income statement, statement of financial position and the statement of cash flows, all of which are inter-related. The information presented in the income statement, the statement of financial position and the statement of cash flows is briefly described below. The Group's summarised financial statements are set out in the Financial Review Summary on pages 50 to 51.

Income statement – this analyses the Group's financial performance for the year, showing profitability and comparatives. The income statement of the Group is set out on page 98 and a detailed discussion of the performance of the Group is set out on pages 55 to 64 of this Financial Review.

Statement of financial position – this summarises the Group's assets and liabilities as at the end of the reporting period and how the net assets were funded. The statement of financial position of the Group is presented on page 100 and a detailed discussion of the financial position of the Group is set out on pages 64 to 67 of this Financial Review.

Statement of cash flows – this provides information about the Group's change in financial position, reconciles the Group's reported income to operating cash flows and analyses how cash generated from operations was applied in investing and financing activities during the year. The statement of cash flows of the Group is set out on page 103 and a detailed discussion of the cash flows is set out on page 68 of this Financial Review.

Non-accounting performance indicators and operational statistics

To enable users of the financial statements to assess the Group's operating performance in a more comprehensive manner, operating and non-accounting financial performance indicators are included in this Financial Review to supplement the information presented in the financial statements. A summary of the key operational statistics of the Group's individual hotels and commercial properties is set out in the Ten Year Operating Summary on pages 94 to 95.

The Group's adjusted net asset value

The Group's financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRS). HKFRS are issued by the Hong Kong Institute of Certified Public Accountants designed for general purpose financial statements. Whilst certain management judgements may be applied when preparing the financial statements, the Group is obliged to follow the framework of HKFRS and a set of prescriptive standards under the HKFRS to measure, recognise and record its transactions; and to present and disclose the resultant accounting effects in its financial statements without any departures.

To ensure the Group's financial statements are in full compliance with the HKFRS, deferred taxation has to be provided for all temporary differences between the carrying amounts of assets and liabilities and their tax bases. Accordingly, the deferred tax liabilities of the Group as at 31 December 2009 included a HK$3,077 million provision, calculated based on the Hong Kong Profits Tax rate, in respect of revaluation surpluses on the Group's Hong Kong investment properties. It is the Directors'

view that all 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 such disposal as the gains would be capital in nature and would be subject to a nil tax rate in Hong Kong. The Directors therefore expect that the aforesaid HK$3,077 million provision made as at 31 December 2009 would not materialise.

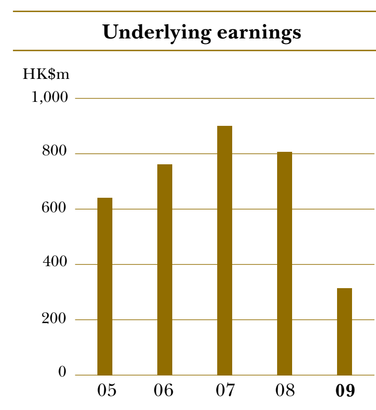
For the purpose of financial statement presentation, the Group has selected the cost model instead of fair value model under the HKFRS as its accounting policy to account for its hotels (other than shopping arcades and offices within the hotels) and golf courses. Under the cost model, hotels and golf courses are measured at depreciated cost less accumulated impairment losses, if any. The fair value model has not been selected in order to avoid the inclusion of unnecessary short term fair value movements in respect of hotel properties and golf courses in the income statement which are considered irrelevant to the underlying economic performance of the hotel and golf course operations. However, in order to provide users of the financial statements with additional information on the value of the Group's net assets, the Directors have commissioned an independent third party fair market valuation of the Group's hotel properties and golf courses as at 31 December 2009, the details of which are set out on page 65. If these assets were to be stated at fair market value instead of at cost less depreciation and any provision for impairment (and deferred tax is not provided on the revaluation surplus of the hotel property in Hong Kong on the same rationale as noted above), the Group's net assets attributable to shareholders would increase by HK$2,424 million.

In the light of the above, the Directors have provided the users of the financial statements with a calculation of the Group's adjusted net asset value as at 31 December 2009 on the basis set out below:

(HK$m)	**2009**		2008	
Net assets attributable to shareholders per audited statement of financial position		**23,040**		20,712
Writing back the deferred taxation provision in respect of revaluation surpluses on Hong Kong investment properties		**3,077**		2,723
Adjusting the value of hotels and golf courses to fair market value	**2,559**		3,826	
Less: Related deferred tax and minority interests	**(135)**		(672)	
		2,424		3,154
Adjusted net assets attributable to shareholders		**28,541**		26,589
Audited net assets per share (HK$)		**15.67**		14.28
Adjusted net assets per share (HK$)		**19.42**		18.34

The Group's underlying earnings

The Group's operating results are mainly derived from the operation of hotels and letting of commercial properties. However, to comply with the HKFRS, the Group is required to include non-operating and non-recurring items, such as the increase in fair value of investment properties and impairment provision adjustments for certain assets, in its income statement. As the Group continues to be managed with principal reference to its underlying operating cash flows and recurring earnings, the Directors have provided for the users of its financial statements calculations of the Group's underlying profit attributable to shareholders and underlying earnings per share, which are determined by excluding the post-tax effects of the property revaluation movements and other non-operating items, as set out below:



(HK$m)	2009	2008
Profit attributable to shareholders	**2,298**	216
(Increase)/decrease in fair value of investment properties	**(1,998)**	593
Net impairment provision adjustments for hotels, golf courses and other properties	**–**	176
Share of net property valuation gain of a jointly controlled entity, net of tax	**(315)**	–
Other non-operating items	**21**	–
Tax and minority interests attributable to non-operating items	**309**	(178)
Underlying profit attributable to shareholders	**315**	807
Underlying earnings per share (HK$)	**0.22**	0.56

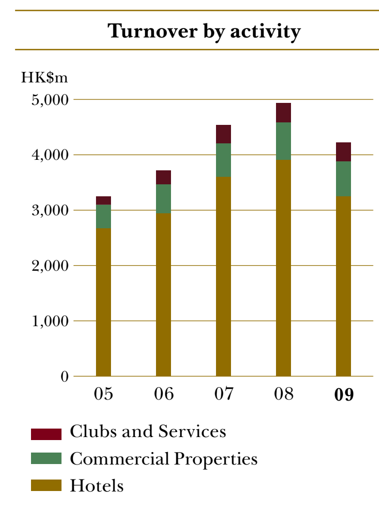
Change in segmental reporting

During 2009, the Group has reclassified its reporting segments to: Hotels, Commercial Properties, and Clubs and Services. This has resulted in a consequential adjustment to certain 2008 figures to reflect the comparative results. In 2008 and previous years, the reporting segments were: Hotels, Non-hotel Properties; and other businesses. We believe the reclassification better reflects the Group's operating segments and aligns with how the Group's performance and resources are managed for strategic growth.

Income Statement

Turnover

The Group's turnover in 2009 amounted to HK$4,218 million, which was HK$720 million or 15% below 2008. The following table sets out the breakdown of consolidated revenues first by business segment and then by geographical segment:



Consolidated revenues by business segment (HK$m)	**2009**		2008	
Hotels				
Rooms	**1,355**	**32%**	1,856	37%
Food and beverage	**1,012**	**24%**	1,166	24%
Commercial	**556**	**13%**	545	11%
Others	**321**	**8%**	338	7%
Total hotel revenue	**3,244**	**77%**	3,905	79%
Commercial Properties	**637**	**15%**	677	14%
Clubs and Services	**337**	**8%**	356	7%
	4,218	**100%**	4,938	100%

Consolidated revenues by geographical location (HK$m)	**2009**		2008	
Arising in				
Hong Kong	**1,870**	**44%**	2,056	42%
Other Asia	**1,429**	**34%**	1,740	35%
United States of America	**919**	**22%**	1,142	23%
	4,218	**100%**	4,938	100%

Hotels During 2009, the hotels division generated a total revenue of HK$3,244 million, representing a decrease of HK$661 million (17%) as compared to 2008. All hotels experienced reduced revenue in 2009 compared with 2008, but the most affected were the Peninsula hotels in Beijing, Chicago and Bangkok, which together accounted for two-thirds of the reduction. The RevPAR in all hotels, apart from The Peninsula Manila, was reduced to levels similar to those achieved in 2004-2005.

The breakdown of revenues by hotels is as follows:

Revenue	2009					2008				
Breakdown of revenues by hotels (HK$m)	**Rooms**	**Food and Beverage**	**Commercial**	**Others**	**Total**	Rooms	Food and Beverage	Commercial	Others	Total
Consolidated hotels										
The Peninsula Hong Kong	**263**	**285**	**371**	**48**	**967**	353	321	362	57	1,093
The Peninsula Beijing	**101**	**55**	**121**	**18**	**295**	236	102	121	26	485
The Peninsula New York	**289**	**86**	**33**	**33**	**441**	354	90	32	10	486
The Peninsula Chicago	**201**	**130**	**–**	**48**	**379**	297	167	–	59	523
The Peninsula Tokyo	**271**	**297**	**26**	**67**	**661**	302	285	25	65	677
The Peninsula Bangkok	**98**	**62**	**3**	**19**	**182**	153	87	3	26	269
The Peninsula Manila	**101**	**70**	**2**	**17**	**190**	115	76	2	17	210
Quail Lodge Resort*	**31**	**27**	**–**	**41**	**99**	46	38	–	49	133
Management fees income	**–**	**–**	**–**	**30**	**30**	–	–	–	29	29
	1,355	**1,012**	**556**	**321**	**3,244**	1,856	1,166	545	338	3,905
Non-consolidated hotels										
The Peninsula Shanghai**	**19**	**21**	**8**	**2**	**50**	–	–	–	–	–
The Peninsula Beverly Hills	**216**	**78**	**–**	**38**	**332**	302	93	–	49	444
	235	**99**	**8**	**40**	**382**	302	93	–	49	444

* *Quail Lodge Resort was closed on 16 November 2009.*
** *The Peninsula Shanghai opened gradually from 18 October 2009 and became fully operational as from 3 December 2009.*

The Peninsula Hong Kong: Total revenue was HK$126 million (12%) lower than 2008, with significantly less revenue from rooms and from food and beverage; although commercial revenue was 2% higher than in 2008. The hotel's RevPAR was 25% lower than 2008, mostly due to lower occupancy, with a noticeable decline in business from long-haul destinations. The lower occupancy impacted on food and beverage revenues, and there was less convention and exhibition business.

The Peninsula Beijing: Total revenue was HK$190 million (39%) below 2008. Occupancy was 34% compared with 50% in 2008, resulting in a 57% lower RevPAR as compared with 2008. The lower occupancy also heavily impacted on the restaurant business levels; although commercial revenue was in line with 2008.

The Peninsula New York: Total revenue was HK$45 million (9%) lower than 2008 principally due to the reduced average room rate, which was 16% lower than in 2008 whilst the hotel's occupancy was just 1.5% lower. The lower average rate resulted in room revenue being HK$65 million (18%) lower than in 2008. The Spa facility re-opened in January 2009 after being closed for almost all of 2008 for renovation, increasing the 2009 Spa revenue by HK$22 million as compared to 2008.

The Peninsula Chicago: Total revenue was HK$144 million (28%) below 2008. Business levels in Chicago have been significantly impacted by the economic environment in the United States, from which approximately 90% of the hotel's room business comes. The hotel's RevPAR was 32% lower than in 2008, with the reduced occupancy also impacting negatively on food and beverage business.

The Peninsula Tokyo: Total revenue was HK$16 million (2%) below 2008; although the hotel's Japanese Yen revenue was 10% lower than 2008. The revenue decline was due mainly to a 10% drop in RevPAR, principally driven by lower average room rate, resulting from the poor business environment in Tokyo. The hotel created many attractive promotions around the "Year of Giving" theme, which have been well received. As a result, food and beverage revenues were only 4% below 2008 and Spa revenue was higher than in 2008.

The Peninsula Bangkok: Total revenue was HK$87 million (32%) below 2008. The political instability, which started in September 2008 and led to a state of emergency and the closure of Bangkok's airports in late November 2008, significantly impacted the tourism industry in Thailand. There has been a significant decline in international visitors, both corporate and leisure, resulting in the hotel's RevPAR declining 35% as compared with 2008, reflecting both lower occupancy and average room rate.

The Peninsula Manila: Total revenue was HK$20 million (10%) below 2008; although the hotel's Philippine Peso revenue was just 2% lower than 2008. The hotel's 2009 revenue was impacted by both the generally poor economic conditions and the strong typhoons in September. The results are not directly comparable with 2008 because half of the hotel's room inventory was not available for sale for five months in 2008 due to the renovation of the Ayala Tower.

Quail Lodge: Total revenue was HK$34 million (26%) lower than in 2008. The hotel portion of the resort closed on 16 November 2009, which resulted in 115 redundancies and associated closure costs of HK$24 million, which was charged to the income statement as a non-operating item. The Golf and Clubhouse remain open to support the approximately 300 members and the property's event business.

Most of the space in the retail arcades in the hotels is leased on long term leases, with rental levels set for the full term of the lease. We have been working closely with the existing tenants through this challenging year to maintain business levels in the commercial arcades and to retain as many tenants as possible. This has been largely successful, resulting in a 2% increase in revenues from the hotels' commercial areas as compared with 2008.

Although the financial results for the Peninsula hotels in Shanghai and Beverly Hills are not consolidated as they are not subsidiaries of the Group, the following comments are included in order to provide a complete review of the operating performance of hotels in the Group.

The Peninsula Shanghai: Total revenue was HK$50 million for the period to 31 December 2009. The hotel opened gradually from 18 October 2009 and became fully operational as from 3 December 2009. The hotel has been promoting attractive introductory room packages since opening, which have been effective in generating awareness of the hotel. There have been major construction works in the area surrounding the hotel, related to the removal of the flyover, and this has made it difficult to access the hotel. This has particularly impacted food and beverage revenue since the opening but it is expected that all such works will be completed by the time of the World Expo in May 2010.

The Peninsula Beverly Hills: Total revenue was HK$112 million (25%) below 2008. Occupancy was 61% compared with 80% in 2008, resulting in a 28% lower RevPAR as compared with 2008. The lower occupancy also impacted on the restaurant and Spa business levels, which were approximately 20% below those of 2008.

Commercial Properties The total rental revenue from commercial properties of HK$637 million was HK$40 million (6%) lower than 2008, mainly due to reduced revenue in The Repulse Bay.

Breakdown of revenues by Commercial Properties (HK$m)	**2009** Residential Properties	**2009** Office	**2009** Shopping Arcade	**2009** Total	2008 Residential Properties	2008 Office	2008 Shopping Arcade	2008 Total
The Repulse Bay Complex, Hong Kong	**385**	**–**	**84**	**469**	412	–	108	520
The Peak Tower, Hong Kong	**–**	**–**	**83**	**83**	–	–	82	82
St. John's Building, Hong Kong	**–**	**36**	**–**	**36**	–	34	–	34
The Landmark, Ho Chi Minh City	**13**	**34**	**2**	**49**	13	25	3	41
	398	**70**	**169**	**637**	425	59	193	677

The Repulse Bay Complex, Hong Kong: Total revenue was HK$51 million (10%) lower than 2008. The average rent per net available square foot (yield) was HK$2.30 (6%) lower than 2008, having been impacted by weaker demand since the global financial crisis. The cycle of residential accommodation revenues is generally longer than hotel revenues, as residential tenancies are typically fixed leases of a 2–year term. The residential rental market seems to have stabilised and monthly revenue has shown some recovery since September 2009.

The Peak Tower, Hong Kong: Total revenue was in line with 2008 despite the generally poor economic conditions. Occupancy in The Peak Tower remains above 99%, with the majority of existing tenants renewing, upon expiry, the leases which were entered into following the revitalisation of The Peak Tower in 2006. Where tenants have vacated their premises, replacement tenants have been identified with limited disruption to the rental revenue flow. The other main source of income for The Peak Tower is the Sky Terrace, where visitor numbers and revenue were in line with 2008.

St. John's Building, Hong Kong and The Landmark, Ho Chi Minh City, Vietnam: Both properties experienced reduced occupancy, but the average rentals increased sufficiently to enable there to be revenue growth as compared with 2008.

Clubs and Services All of the businesses in this division suffered reduced revenue as compared with 2008; the combined revenue was HK$19 million (5%) below 2008.

Breakdown of revenues by individual operations of the Clubs and Services division (HK$m)	**2009**	2008
Clubs and Consultancy Services	**102**	103
Peak Tram	**79**	81
Peninsula Merchandising	**75**	81
Thai Country Club	**52**	58
Tai Pan Laundry	**29**	33
	337	356

The revenue from Clubs and Consultancy Services is mainly generated from the management of the Cathay Pacific Airport Lounges, where the management fees are based on the number of passengers using the first and business class lounges. With 6% less passengers, management fee revenue was 2% less than in 2008. Management fees related to clubs in Hong Kong were also slightly lower than in 2008, due to the weaker trading environment and operating results.

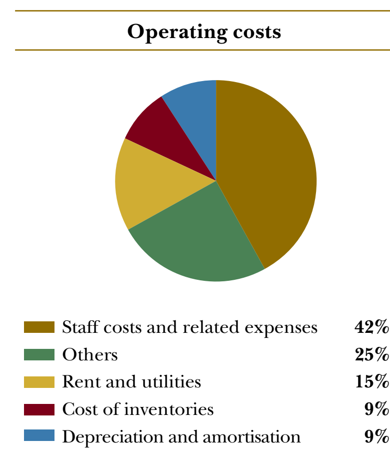
The number of passengers on The Peak Tram was 3% lower than in 2008, with a comparable reduction in revenue, mainly due to fewer visitor arrivals to Hong Kong. There was also a 3-day service suspension for the replacement of a tram haulage rope. The revenue in Peninsula Merchandising was HK$6 million (7%) lower than 2008, with reduced revenue from all of the wholesale markets due to the generally poor economic conditions.

The number of golf rounds in Thai Country Club was 6% lower than in 2008, which resulted in HK$6 million (10%) less revenue, due to the generally poor economic conditions and the political instability resulting in reduced levels of tourism in Thailand. The reduced revenue in Tai Pan Laundry was caused by reduced laundry and dry cleaning volumes from hotels in Hong Kong, which experienced reduced occupancy levels compared with 2008.

Operating costs

Operating costs in 2009 were 6% lower than that of 2008, compared with the revenue shortfall of 15%. In the light of the difficult operating environment, additional attention was paid to maintaining and controlling operating costs. A more thorough monthly forecasting process was put in place in order to give a clearer group wide view of the expected operating and cash flow performance. Cash flow was a key focus, first to meet operational needs and then capital funding requirements. The effective management and control of staffing and payroll also required particular attention, as did the strict control of all credit facilities granted to our customers.

Operating costs



Staff costs and related expenses	**42%**
Others	**25%**
Rent and utilities	**15%**
Cost of inventories	**9%**
Depreciation and amortisation	**9%**

The management teams were tasked to maintain tight control of costs, whilst also making every effort to generate incremental revenue and maintain the highest standards of product and service. Cost control was more challenging given certain external pressures on costs such as union negotiated wage increases, property and real estate tax increases and energy price increases. The management teams also worked closely with suppliers to renegotiate contracts and obtain more favourable terms.

In general, vacant positions resulting from staff resignations were not filled and there was a hiring freeze implemented across the group throughout the year. In addition, where possible, staff worked reduced hours or were re-deployed or multi-tasked to improve efficiency. Salary increments have been limited, although we have awarded merit increases where considered appropriate. We regard our staff as a key component in the value of the Peninsula brand, and are mindful of the investment to recruit and develop this resource.

The combination of these measures has been effective in optimising cash flow, reducing the fixed cost base, and enabling us to avoid making any wholesale redundancies across the group. We consider the right mix has been attained between reducing the cost base and retaining staff.

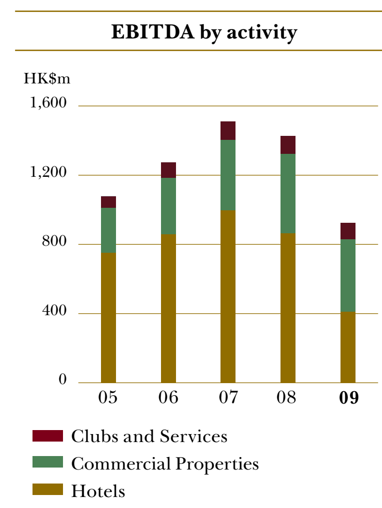
HK$1,512 million or 42% of direct operating costs are payroll-related. This proportion is in line with that of the previous year. The breakdown of full time employee numbers as at 31 December was as follows:

Number of full time employees	**2009**			2008		
	Direct Operations	**Managed Operations**	**Total**	Direct Operations	Managed Operations	Total
By division:						
Hotels	**4,367**	**1,122**	**5,489**	4,808	431	5,239
Commercial Properties	**339**	**–**	**339**	339	–	339
Clubs and Services	**605**	**393**	**998**	659	397	1,056
	5,311	**1,515**	**6,826**	5,806	828	6,634
By geographical location:						
Hong Kong	**1,662**	**393**	**2,055**	1,737	397	2,134
Other Asia	**2,705**	**760**	**3,465**	2,938	–	2,938
United States of America	**944**	**362**	**1,306**	1,131	431	1,562
	5,311	**1,515**	**6,826**	5,806	828	6,634

The increased number of full time employees in Managed Hotel Operations in 2009 includes the staffing for The Peninsula Shanghai, which opened in October 2009. Without the newly opened hotel, the Managed Hotel Operations would also have shown a decreased number of employees.

EBITDA and EBITDA margin

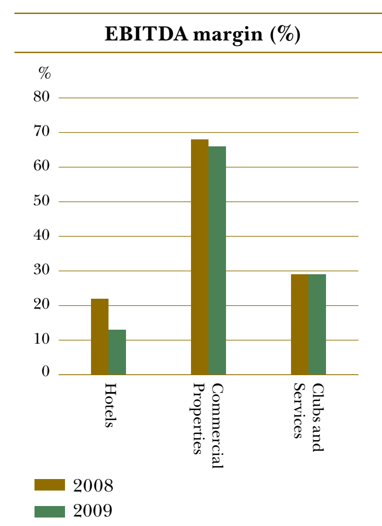
EBITDA (earnings before interest, taxation, depreciation and amortisation) decreased by 35% to HK$924 million.



EBITDA (HK$m)	Hong Kong	Other Asia	United States of America	Total	Change 2009/2008
2009					
Hotels	**419**	**52**	**(61)**	**410**	(52%)
Commercial Properties	**386**	**32**	**–**	**418**	(9%)
Clubs and Services	**81**	**15**	**–**	**96**	(6%)
	886	**99**	**(61)**	**924**	(35%)
2008					
Hotels	500	279	84	863	
Commercial Properties	434	26	–	460	
Clubs and Services	86	16	–	102	
	1,020	321	84	1,425	

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

EBITDA margin	**2009**	2008
Hotels	**13%**	22%
Commercial Properties	**66%**	68%
Clubs and Services	**28%**	29%
Overall EBITDA margin	**22%**	29%
Arising in:		
Hong Kong	**47%**	50%
Other Asia	**7%**	18%
United States of America	**(7%)**	7%



The Hotels division is subject to a relatively high fixed cost base by nature of its businesses, resulting in a greater impact on the EBITDA and the EBITDA margin from a reduction of revenue than would be the case if the fixed cost base was lower. The revenue shortfall during 2009 in the Hotels division had the largest impact on EBITDA.

The decreased EBITDA margin in the Commercial Properties division was mainly attributed to The Repulse Bay, which experienced decreased average rental rates and the closure of the two main restaurants for renovation for five months.

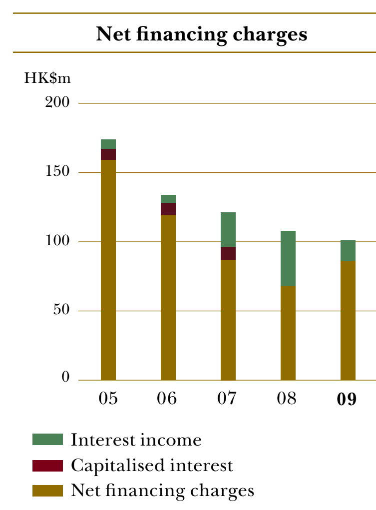
Depreciation and amortisation

The depreciation and amortisation charge of HK$338 million (2008: HK$374 million) largely relates to the hotels. The Group's hotels are subject to a planned maintenance programme in which capital expenditure is incurred on an ongoing basis for refurbishment and improvement. Therefore, depreciation and amortisation normally account for a significant portion of the Group's fixed overheads. It should be noted that of the total depreciation figure, HK$140 million (2008: HK$145 million) relates to depreciation and amortisation of land and buildings, which would not be required if the hotels were accounted for on a fair market value basis instead of the cost and depreciation basis as currently adopted.

Net financing charges

Financing charges on borrowings in 2009 amounted to HK$101 million (2008: HK$108 million). After netting off interest income of HK$15 million (2008: HK$40 million), a net charge of HK$86 million (2008: HK$68 million) was recognised in the income statement. The 26% increase in net financing charges was mainly due to the decrease in money market deposit rates in 2009 and the reduction in cash balance following the payment of HK$1,044 million consideration in respect of the Peninsula Paris project on 20 January 2009.

The weighted average gross interest rate for the year reduced to 3.2% (2008: 3.4%) after accounting for all hedging activities. Interest cover (operating profit divided by net financing charges) reduced to 6.8 times (2008: 15.5 times) in 2009, mainly due to the decrease in operating profit as a result of the reduction in turnover.



Non-operating items

The non-operating items are analysed below.

(HK$m)	**2009**	2008
Increase/(decrease) in fair value of investment properties	**1,998**	(593)
Gain on disposal of investment properties	**18**	–
Provision for impairment for hotels and golf courses	**–**	(176)
Impairment loss on interest in associates	**(15)**	–
Closure costs for Quail Lodge Resort	**(24)**	–
	1,977	(769)

The increase in fair value of investment properties for the year was principally attributable to the increase in value for The Repulse Bay Complex and the shopping arcade at The Peninsula Hong Kong. Such increase was a reflection of the improved fundamentals for the Hong Kong property market towards the end of the year, in particular, for luxury residential market and high-end commercial properties.

During the year, the Group disposed of a piece of land in Phuket to a third party and realised a net gain of HK$18 million after accounting for all transaction costs.

On 20 January 2009, the Group invested a total of HK$1,044 million (Euro 102 million) into the Peninsula Paris project. Of this amount, HK$453 million (Euro 44.3 million) was attributed to the acquisition of a 20% equity interest and the related shareholder's loan in Al Maha Majestic S.à r.l. (Al Maha), a company incorporated in Luxembourg, which indirectly owns a 100% interest in a property in Paris to be redeveloped into The Peninsula Paris hotel. HK$591 million (Euro 57.7 million) was attributed to the acquisition of the right to manage The Peninsula Paris upon completion of the property redevelopment. As at 20 January 2009 (the date of completion of acquisition), the Group's share of the fair value of Al Maha's consolidated net assets and shareholder's loan amounted to HK$438 million. The goodwill of HK$15 million, being the difference between the purchase consideration of HK$453 million and the Group's share of the fair value of Al Maha's net assets and shareholder's loan of HK$438 million, was written off as impairment loss during the year.

As part of the Group's initiatives to contain costs and improve operating performance, the resort operation of Quail Lodge, Inc. (a wholly-owned subsidiary of the Group which was acquired in 1997) was closed on 16 November 2009. The costs incurred for the closure of the resort were non-recurring in nature and were therefore written off as non-operating items in the income statement.

Share of profit/(loss) of a jointly controlled entity

The Group has a 50% interest in The Peninsula Shanghai complex which is owned by a jointly controlled entity. The complex comprises a hotel, a commercial retail arcade and an apartment hotel of 39 units. The hotel and the commercial retail arcade soft opened on 18 October 2009 and 3 December 2009 respectively. The Group's share of profit in relation to The Peninsula Shanghai of HK$285 million was net of a post-tax non-operating gain of HK$315 million arising from the property valuation adjustments (2008: HK$nil) and pre-opening expenses of HK$37 million (2008: HK$5 million) respectively.

Taxation

The breakdown of the taxation charge is as follows:

(HK$m)	**2009**	2008
Current tax	**120**	185
Deferred tax:		
Deferred taxation on non-operating items	**308**	(163)
Effect of reduced tax rate on deferred tax balances	**–**	(175)
Increase in net deferred tax liabilities relating to other temporary differences	**30**	111
Net tax charge/(credit) in the income statement	**458**	(42)

The decrease in current tax and deferred tax in respect of other temporary differences was mainly due to the decrease in operating profit.

During 2009, the fair value of the Group's investment properties increased by HK$1,998 million (2008: decreased by HK$593 million) and this resulted in a provision for deferred tax liabilities in respect of revaluation surpluses amounting to HK$308 million (2008: reversal of deferred tax provision amounted to HK$163 million due to a decrease in fair value of investment properties).

As at 31 December 2009, the deferred tax provision in respect of accumulated revaluation surpluses on the Group's investment properties amounted to HK$3,191 million (2008: HK$2,881 million), of which HK$3,077 million (2008: HK$2,723 million) related to Hong Kong investment properties. The Directors consider that the provision for deferred tax liabilities with regard to revaluation surpluses on the investment properties in Hong Kong will not materialise on the grounds that the Group has no intention to sell these properties and, should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in Hong Kong.

Statement of financial position

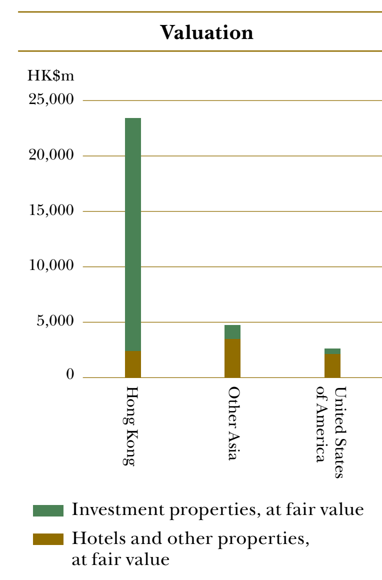
Fixed assets

The Group has interests in and manages nine operating hotels in Asia and the USA and is developing a hotel in Paris, in which the Group has a 20% interest.

In addition to hotel properties, the Group owns residential apartments, office towers and commercial arcades for rental purposes.

According to the Group's accounting policies, hotel properties (other than shopping arcades and offices within the hotels) and golf courses are stated at cost less accumulated depreciation and any provision for impairment losses, whilst investment properties are stated at fair value. In order to provide users of the financial statements with additional information on the current market value of our hotels and golf courses, the Directors have commissioned independent valuers to perform a fair valuation of these properties (except for The Peninsula Beverly Hills which is 20% owned by the Group) as at 31 December 2009. At the same time, an independent valuation was also performed for the Group's investment properties in accordance with the accounting policies.

A summary of the Group's hotel, investment and other properties showing both the book value and the market value as at 31 December 2009 is set out in the following table.



	Market Value (HK$m)	**Book Value** (HK$m)
Hotels		
Consolidated hotels		
The Peninsula Hong Kong	**9,233**	**7,586**
The Peninsula Beijing	**1,687**	**1,304**
The Peninsula New York	**1,337**	**1,007**
The Peninsula Chicago	**1,123**	**1,108**
The Peninsula Tokyo	**1,399**	**1,159**
The Peninsula Bangkok	**746**	**830**
The Peninsula Manila	**303**	**284**
Quail Lodge Resort and Golf Club	**91**	**82**
	15,919	**13,360**
Jointly controlled entity ***(value attributable to the Group)***		
The Peninsula Shanghai (50%)	**1,658**	**1,658**
Total for hotels	**17,577**	**15,018**
Commercial properties		
The Repulse Bay	**7,692**	**7,692**
Repulse Bay Apartments	**4,801**	**4,801**
Repulse Bay Garage	**85**	**85**
The Peak Tower	**983**	**983**
St. John's Building	**612**	**612**
The Landmark	**89**	**89**
Total for commercial properties	**14,262**	**14,262**
Other properties		
Thai Country Club golf course	**221**	**221**
Vacant land near Bangkok	**300**	**300**
Quail Lodge land	**62**	**62**
Other Hong Kong properties	**42**	**30**
Total for other properties	**625**	**613**
Total	**32,464**	**29,893**

Interest in a jointly controlled entity

The balance of HK$815 million as at 31 December 2009 (2008: HK$539 million) represented the Group's 50% indirect interest in The Peninsula Shanghai Waitan Hotel Company Limited, a wholly-owned foreign enterprise incorporated in the People's Republic of China which owns 100% of The Peninsula Shanghai. The increase in balance was mainly due to the Group's share of HK$285 million profit (2008: HK$5 million loss) of this jointly controlled entity during 2009. As explained above, this profit figure includes a post-tax non-operating gain of HK$315 million (2008: HK$nil).

Interests in associates

The balance of HK$498 million as at 31 December 2009 (2008: HK$nil) represented the Group's 20% equity interest and 20% share of the related shareholder's loan in Al Maha Majestic S.à r.l., a company incorporated in Luxembourg which indirectly owns a 100% interest in a property in Paris to be redeveloped into The Peninsula Paris hotel. This hotel will be managed by the Group upon completion of the redevelopment, expected to be in 2012.

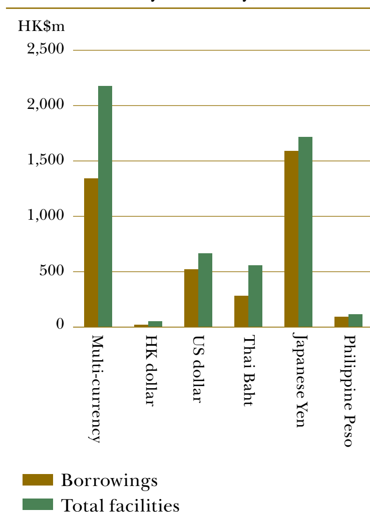
Investment in hotel management contracts

As at 31 December 2009, investment in hotel management contracts amounted to HK$730 million as compared to HK$92 million in 2008. The increase in the balance was mainly due to the inclusion of attributed consideration of Euro 57.7 million (HK$641 million translated at the exchange rate ruling at the end of the reporting period) in respect of the right acquired to manage The Peninsula Paris to be developed jointly by the Group and its associate, Al Maha Majestic S.à r.l.

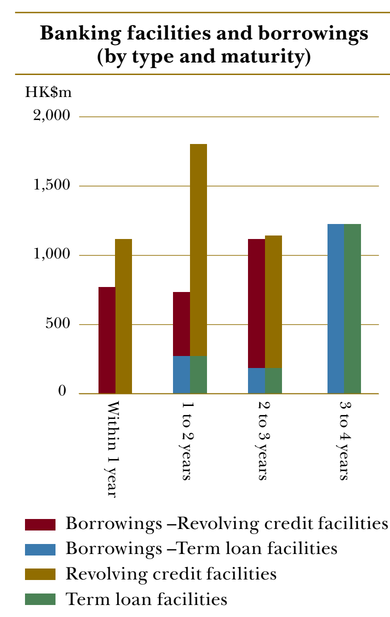
Borrowings

During the year, gross borrowings increased by 20% to HK$3,825 million (2008: HK$3,193 million) principally as a result of a successful term loan financing undertaken in June 2009. Consolidated net borrowings increased to HK$1,990 million (2008: HK$1,198 million), taking account of cash of HK$1,835 million (2008: HK$1,995 million). The reduction in cash was principally due to the investment in connection with The Peninsula Paris.

Banking facilities and borrowings (by currency)



In addition to the Group's consolidated borrowings, The Peninsula Beverly Hills (20% owned) and The Peninsula Shanghai (50% owned) have non-recourse bank borrowings, which are not consolidated in the statement of financial position as the entities owning the assets are not subsidiaries of the Company. The consolidated and non-consolidated borrowings as at 31 December 2009 are summarised as follows:



(HK$m)	2009 Hong Kong	Other Asia	United States of America	Total	2008 Total
Consolidated gross borrowings	**1,342**	**1,961**	**522**	**3,825**	3,193
Non-consolidated borrowings attributable to the Group:					
The Peninsula Beverly Hills (20%)	–	–	**218**	**218**	218
The Peninsula Shanghai (50%)	–	**930**	–	**930**	422
Non-consolidated borrowings	–	**930**	**218**	**1,148**	640
Consolidated and non-consolidated gross borrowings	**1,342**	**2,891**	**740**	**4,973**	3,833
Pledged assets attributable to the Group					
For consolidated borrowings	–	–	–	–	–
For non-consolidated borrowings	–	**2,067**	**189**	**2,256**	1,210
	–	**2,067**	**189**	**2,256**	1,210

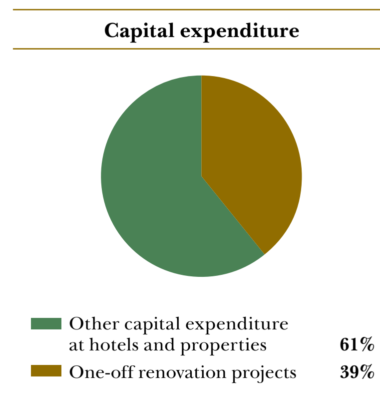
Derivative financial instruments

Derivative financial instruments are generally used to hedge interest rate and exchange rate risks of the Group and are recorded at their fair values.

Statement of cash flows

Net cash generated from operating activities decreased to HK$761 million as compared to HK$1,208 million in 2008. The decrease was mainly due to the significant reduction in revenue, mainly from the hotels segment as explained above. Most of the operating cash flows were applied to capital expenditure, repayment of borrowings and payment of dividends.

Capital expenditure



Other capital expenditure at hotels and properties	61%
One-off renovation projects	39%

On 20 January 2009, The Group paid a total of HK$1,044 million in respect of the Peninsula Paris project. Of this amount, HK$453 million was attributed to the investment of a 20% interest in Al Maha Majestic S.à r.l., a company incorporated in Luxembourg, which indirectly owns a 100% interest in a property in Paris to be redeveloped into The Peninsula Paris hotel and HK$591 million was attributed to the acquisition of the right to manage this hotel upon completion of the redevelopment. The entire sum of HK$1,044 million consideration was funded by the Group's surplus cash.

Excluding the cost of investment in the Peninsula Paris project, capital expenditure and payment for acquiring an additional interest in a subsidiary incurred by the Group during 2009 amounted to HK$360 million (2008: HK$420 million) and the breakdown of this sum is as follows:

(HK$m)	2009	2008
One-off renovation projects	**106**	217
Capital expenditure at hotels and properties	**163**	200
Payment for the acquisition of an additional interest in a subsidiary	**91**	3
	360	420

The net cash outflow after capital expenditure, interest and dividends before financing activities for the year was HK$824 million, compared to an inflow of HK$597 million in 2008. The net cash outflow was mainly due to the payment of HK$1,044 million for the Peninsula Paris project as explained above.

After accounting for investing and financing activities and excluding bank deposits maturing more than three months amounting to HK$437 million (2008: HK$ nil), cash and cash equivalents as at 31 December 2009 amounted to HK$1,380 million (2008: HK$1,979 million).

Off balance sheet information

The following transactions and events are not reflected in the Group's income statement, statement of financial position and statement of cash flows but are considered relevant to the users of the financial statements.

Capital commitments

The Group is committed to enhancing the asset value of its hotel and investment properties and improving the service quality of these assets. As at 31 December 2009, the Group's capital commitment amounted to HK$738 million (2008: HK$2,939 million) and the breakdown is as follows:

(HK$m)	2009	2008
Capital expenditure		
Contracted for	**80**	109
Authorised but not contracted for	**394**	486
	474	595
Investment in the Peninsula Paris project (note)		
Authorised but not contracted for	**–**	1,572
The Group's share of capital commitments of a jointly controlled entity		
Contracted for	**40**	343
Authorised but not contracted for	**224**	429
	264	772
	738	2,939

Note: The capital commitment in respect of investment in the Paris project for 2008 consisted of cash consideration payable for the acquisition of a 20% interest in Al Maha Majestic S.à r.l. (Al Maha) and the related hotel management contract and the Group's expected share of redevelopment cost of the Paris property.

The Group holds a 20% equity interest in Al Maha Majestic S.à r.l. (Al Maha), an associate of the Group responsible for the development of the Peninsula Paris project. The Group's 20% share of the contracted for and authorised but not contracted for capital commitments as at 31 December 2009 amounted to HK$37 million (2008: HK$ nil) and HK$474 million (2008: HK$ nil) respectively. It is planned that these capital commitments will be financed by way of bank borrowings by the associate and only in the event of the associate being unable to arrange the funding would the Group be required to meet the shortfall.

Contingent liabilities

Contingent liabilities as at 31 December 2009 for the Group and the Company are analysed as follows:

	Group		Company	
(HK$m)	2009	2008	2009	2008
Guarantees given in respect of borrowings and other banking facilities for subsidiaries	**–**	–	**3,866**	3,135
Other guarantees	**1**	1	**1**	1
	1	1	**3,867**	3,136

The Directors consider that the above contingent liabilities are unlikely to materialise. Therefore, no provision was made in the financial statements.

Non-adjusting post reporting period event

After the end of reporting period, the Directors proposed a final dividend of 6 HK cents per share in respect of the year ended 31 December 2009, which will be payable on or about 25 June 2010. The final dividend is subject to the approval by shareholders at the forthcoming Annual General Meeting to be held on 12 May 2010 and no provision was made in the financial statements.

Treasury management

All the Group's financing and treasury activities are centrally managed and controlled at the corporate level, where the majority of the Group's funding needs, currency and interest rate risk exposures are monitored.

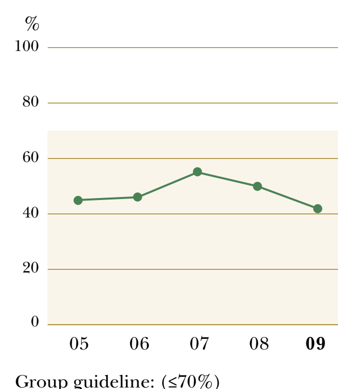
Within the same policy framework, some operating subsidiaries monitor financial risks that are specific to particular transactions within their operations. Associated and jointly controlled companies arrange their own financial and treasury affairs based on their circumstances on a stand-alone basis.

Liquidity risk

The Group's policy is to regularly monitor current and expected liquidity requirements and compliance with loan covenants to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments. On 25 June 2009, HSH Financial Services Limited, a wholly-owned subsidiary, signed a HK$1,225 million four year term loan facility with a syndicate of seven international banks (namely Australia and New Zealand Banking Group Limited, Bank of China (Hong Kong) Limited, The Bank of Tokyo-Mitsubishi UFJ, Ltd., Crédit Agricole Corporate and Investment Bank, HSBC, Industrial and Commercial Bank of China (Asia) Limited and Standard Chartered Bank (Hong Kong) Limited). This facility is unsecured and guaranteed by the Company.

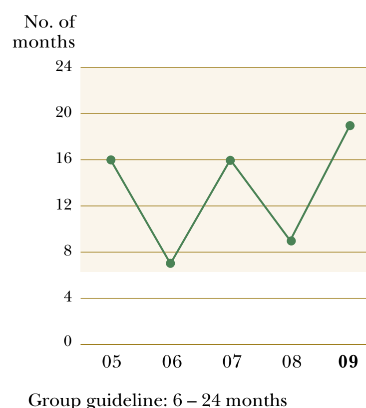
Borrowing requirements are not seasonal as the Group benefits from a steady inflow of income from its leased properties and there is only minor seasonality in its hotel operations. Borrowing requirements tend to follow the pattern of capital expenditure and investment. As such, the level of borrowing facilities is monitored to ensure sufficient funding whenever there is any potential corporate activity with significant cash flow implication. Whilst all funding methods will be considered, bank financing is currently the Group's main source of funding.

Top 3 banks' aggregated committed facility exposure



Group guideline: (≤70%)

Financing horizon



Group guideline: 6 – 24 months

In addition, the Group seeks to maintain a balanced debt maturity profile to minimise refinancing risk.

Generally speaking, mortgage or pledge of assets is not provided to secure borrowing facilities unless significant cost savings or non-recourse financing can be obtained.

The Group monitors its gearing in accordance with the policy that its adjusted gearing ratio, expressed as the percentage of net borrowings to the total of net borrowings and net assets after taking into account the Group's share of net borrowings and net assets of non-consolidated entities (such as The Peninsula Beverly Hills and The Peninsula Shanghai), should be maintained at below 40%. As at 31 December 2009, the Group's gearing and adjusted gearing (including share of net borrowings of non-consolidated entities) increased to 8% (2008: 5%) and 12% (2008: 8%) respectively.

Care is taken to ensure that borrowing facilities do not impose unduly onerous or restrictive covenants and that the terms of the facilities match the underlying funding requirements. The Group's financial position is reviewed periodically to ensure compliance with loan covenants.

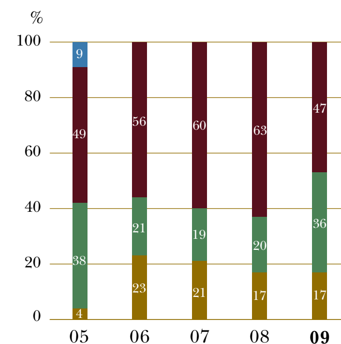
Interest rate risk
The Group's interest rate risk management policy focuses on reducing the Group's exposure to changes in interest rates.

In addition to raising funds directly on a fixed rate basis, the Group may use interest rate swaps or cross currency interest rate swaps in managing its long term interest rate exposure. The policy of Fixed and Floating Rate Mix is between 40:60 and 70:30 with a long term target of 50:50.

As at 31 December 2009, the Group's fixed to floating interest rate ratio remained at 49% (2008: 49%).

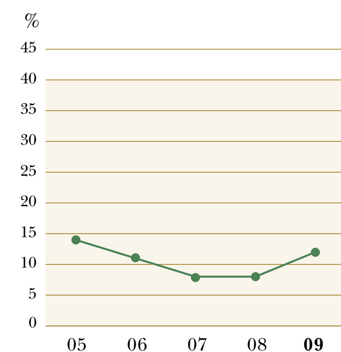
Foreign exchange risk
Significant exposure to movements in exchange rates on individual transactions is monitored and may be hedged by using spot or forward foreign exchange contracts or other derivative financial instruments where active markets for the relevant currencies exist. All significant foreign currency borrowings are usually covered by appropriate currency hedges. Accordingly, the Group does not have any unhedged borrowings denominated in non-functional currencies, other than US$ borrowings in Hong Kong.

Maturity profile of committed facilities



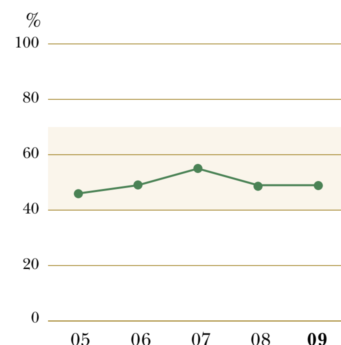
Group guideline:
Beyond 5 Years (≤30%)
2 – 5 Years (30% – 80%)
1 – 2 Years (≤50%)
Due within 1 Year (≤30%)

Adjusted gearing



Group guideline: (≤40%)

Long term fixed-to-total borrowings (adjusted for the hedging effect)

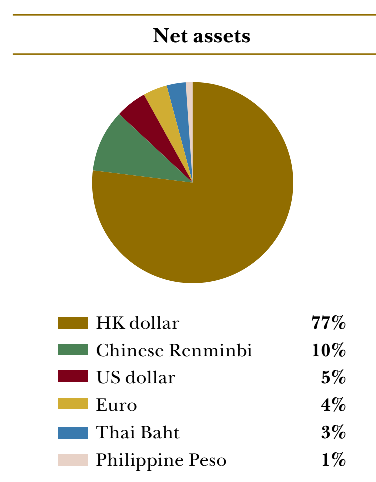


Group guideline: (40% – 70%)

Translation exposure arising on consolidation of the Group's overseas net assets is reduced, where practicable, by matching assets with borrowings in the same currency or by any other means.

The long term financial obligations of the Group's entities are normally arranged in currencies in which they have substantial positive operational cash flows, thereby establishing natural currency hedges.

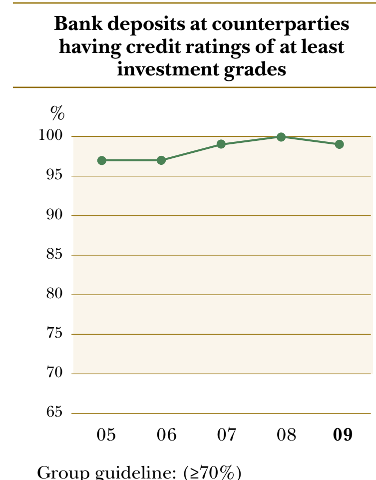
As at 31 December 2009, after accounting for currency hedging, approximately 77%, 10%, 5%, 4%, 3% and 1% (2008: 78%, 9%, 7%, 0%, 5% and 1%) of the Group's net assets were denominated in Hong Kong dollar, Chinese Renminbi, United States dollar, Euro, Thai Baht and Philippine Peso respectively.



Credit risk

Under normal circumstances, when depositing surplus funds or entering into derivative contracts, the Group manages its exposure to non-performance of counterparties by transacting with counterparties which have a credit rating of at least an investment grade. However, in developing countries, it may be necessary to deal with banks of lower credit ratings.

Derivatives are used solely for hedging purposes and not for speculation and the Group only enters into derivative transactions with counterparties which have credit ratings of at least investment grades, even in developing countries, because of the longer term effect.



Share Information

The Company's share price closed on 12 March 2010 at HK$11.34, giving a market capitalisation of HK$16.7 billion (or US$2.1 billion). This reflects a discount of 28% to net assets attributable to shareholders of the Company, or a discount of 42% to the adjusted net assets (see page 53).