

EXTERNAL ENVIRONMENT AND INDUSTRY TRENDS

The hotel industry has been catering to travellers' needs for thousands of years, from the earliest inns of Medieval Europe to today's robot-staffed trendy boutique hotels. Luxury hotels started to be developed at the end of the 19th century to cater to a niche group of wealthy clientele who wanted the same level of comfort and luxury they could find at home. This is how the HSH story began – with Hong Kong's first luxury hotel in 1866 catering to affluent European adventurers travelling to the Far East on steamships or by rail, as the world started to become more connected.

The basic tenets of our industry have not changed. Trade, diplomacy, political events, weddings and family gatherings take place within our walls. Happy guests are loyal guests and they will return and continue to create sustainable value for the company if their expectations are met and exceeded on each visit. However, certain industry trends are moving at unprecedented speed and competition is intensifying.

In this chapter, we have identified various external factors and industry trends together with our key stakeholders which may impact our business. These include aspects of the macroeconomic context in which we operate, as well as environmental challenges, technological changes, terrorist threats and issues specific to the hospitality industry. The objective is to give our shareholders some insight into the external environment in which we operate, in accordance with the *International Integrated Reporting Council Framework*.

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Retail Environment in Hong Kong

The Hong Kong retail market was challenging in 2016 and we experienced a small decline in revenue during the year. As a landlord of various shopping arcades located in our hotels and commercial properties, we acknowledge the pressure this challenging market placed on our retail tenants. JLL's *Retail Atelier* report in January 2017 observed that "Hong Kong's position as a shopper's paradise is far from lost", and the retail trend was moving away from luxury watches and jewellery towards middle market brands and experiences, with a more diverse retail offering becoming available on Hong Kong's streets and shopping malls. We expect that the long-term success of Hong Kong as a retail hub will continue and there is a niche market for innovative luxury shopping. The Peninsula also benefits from an emotional connection with our tenants as a destination shop for items such as fine jewellery. We will continue to work with our tenants on promoting traffic to our Arcades.

Consolidation

Consolidation was the buzzword of the hospitality industry in 2016, with the most notable example being the Marriott and Starwood US\$13.6 billion merger to become the world's largest hotel company in September 2016. Chinese companies have also been increasing their investments overseas – Anbang Insurance, which purchased Waldorf Astoria in New York for US\$1.95 billion in 2014, has spent more than US\$30 billion in the past two years on purchasing luxury hotels, real estate and financial deals. The HNA Group purchased a 25% stake of Hilton Worldwide Holdings Inc in October 2016, as well as Carlson Hotels Inc, owner of Radisson hotels. The benefit of such consolidation is to drive efficiencies, build scale and to capture more customers as partner brands can promote their sister properties.

At HSH, we do not intend to follow this trend of consolidation and building on a large scale. Our business model and strategy is to focus on owning and operating a small number of the world's best properties and hotels. We do not want to be the biggest – our development pipeline, currently three hotel projects – is the largest we have ever taken on in terms of financial and human resources as an owner-operator. However, despite our relatively small size in comparison to such giant companies, we aim to be among the best in the world and we recognise the need to keep innovating and providing a superior guest experience to ensure that we do not lose our competitive edge. More details on our approach to guest experience can be read on page 10 of the Corporate Responsibility and Sustainability Report.

Sharing Economy

The "sharing economy", of which Airbnb is the most famous example, is growing from strength to strength. Airbnb welcomed its 100-millionth guest in July 2016 and its revenue increased by 80% in 2016. It is popular with younger travellers who are looking to have a "local" experience and to feel integrated with the local community. At HSH we are responding to this trend by developing highly bespoke, curated experiences and traditional hospitality for discerning guests. The inimitability of the Peninsula brand offers guests

a full service model, including bespoke experiences through The Peninsula Academy programmes, which introduce each Peninsula destination with highly curated experiences to allow guests to learn about the local culture.

“Sharing economy” companies are operating in uncharted legal territory and are not subject to the stringent health and safety regulations that traditional hotels are subject to, and we believe discerning guests will demand a certain level of service which unregistered accommodation cannot provide. Regulation regarding tax payments has already started in New York City and we expect this to occur in other global cities in due course. However, we continue to monitor the fast-moving developments in the shared economy and its move towards the ultra-luxury sector.



Millennials

Millennial travellers are defined as being 18 to 34 years old, so-called “Generation Y” and much has been written in the mainstream media about their expectations for brands and their growing consumption power. In 2016, ahead of our General Managers’ conference in Hong Kong, we conducted research of a group of more than 20 “millennials” from around the world and asked their views on hotels and luxury brands. The findings were interesting and we concluded that millennials views are, in fact, not so dissimilar to other generations. They want an excellent location at the heart of the city, they want to have unique experiences, and they want digital convenience and the ability to read honest and transparent social media reviews. We are adjusting our digital marketing strategy to adapt and respond to these influential travellers.

Technology

Mobile room keys, remote controlled rooms, robotic staff, smart mirrors and innovative products are making headlines around the world. HSH’s approach to technology is to ensure we have the most modern and seamless technology for our guests, but we insist that it must be functional. Technology for the sake of being trendy, if it doesn’t work, is only frustrating for the guest. Likewise, we firmly believe that technology can never replace the warm personalised service that makes the Peninsula brand unique.

To keep abreast of industry trends and ensure that we are responding appropriately, as well as keeping ourselves protected against Cybersecurity risks, in 2016 we established a Technology Steering Committee (TSC) which integrates HSH’s IT, Research and Technology, Marketing, and Finance Departments to oversee the strategic direction of the company’s technology innovation, research and product development programs. TSC will deliver on the value of technology, service, efficiency, financial resource allocation and organisational performance at HSH for long-term commercial benefit.

We are also taking a closer look at Big Data and how this can translate into a better guest experience. Our objective is to optimise our web and digital channels to offer the most inspiring, useful, and bespoke experience in the luxury sector – one that will not only express the essence and DNA of the Brand, but also drive additional revenue and to generate new or connected sales leads across the Group (for example rooms, F&B, spa, events and online gifting) by delivering the right experience, to the right person, at the right time.

More details can be read on page 106 “150 Years of Innovation”.

Terrorist Threats

HSH is expanding its global portfolio at a time of increasing security threats and terrorism attacks. The terrorist threat is truly global and incidents have occurred in several of the countries where HSH people and assets are based. HSH has adopted a top-down, proactive management approach to mitigate security threats, with the objective of safeguarding our guests, staff, assets and brand to the best of our ability. However, we are conscious that we must strike a balance between ensuring high levels of security while ensuring the freedom of movement and privacy for

our guests. It is an unfortunate reality in today’s world that one can never be 100% protected against terrorists in a free and open society.

The strategy we have adopted to mitigate this risk is to strengthen our network with security stakeholders including local intelligence agencies and police departments, and to enhance our global intelligence monitoring. In 2016, we conducted a series of risk and insurance workshops to assess the adequacy of our policies with regards to cybersecurity, terrorism, property damage and business interruption. We boosted our Crisis Management Center capabilities with increased focus on video conferencing capabilities. As a company with frequent staff travel, we already have global security and medical evacuation capabilities through renowned international service providers, and we enhanced travel security protection and tracking for staff, with a particular focus on Istanbul.

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In a statement on the global terrorist threat issued in July 2016, the World Travel and Tourism Council (WTTC) commented: “The intrinsic value of the travel and tourism sector is to bring people together and to foster dialogue between different cultures and traditions. An open tourism sector contributes positively to the attitudes, institutions and structures that create and sustain peaceful societies. Disrupting this peace is what terrorists aim to do with these meaningless attacks. This is precisely why the Council and the tourism sector at large encourage people to travel as a means to unite in our common humanity.”

HSH supports this statement and follows such industry guidelines closely when developing our risk management and security strategies.

Climate Change and Sustainability

Climate change is a significant challenge facing the world today and has been included in the online CRS report on page 21. Scientists have warned that climate change

impact would become catastrophic and irreversible if global temperature increases by two degrees above pre-industrial levels.

The hotel industry is increasingly focused on integrating climate change into business strategy with commitment at executive and board level, and at HSH we have implemented such a strategy since 2013. As outlined in the Group’s Sustainable Luxury Vision 2020, making our business more resilient to climate impact and reducing greenhouse gas emissions associated with our own business and our value chain is important to our group. Our approach to implementing sustainability strategy is not from a position of idealism or seeking to “change the world”, but rather we regard it as a sensible and inevitable business decision that benefits the short, medium and long-term economic value of our group. We aim to do this in a way that complements our heritage of quality, thoughtfulness and meticulous attention to detail. More details can be read in the Corporate Responsibility and Sustainability report.