Management Discussion & Analysis

1. CORPORATE REORGANISATION – UPDATE

On 22 February 2001, the Company acquired a further 9.61% of the paid-up ordinary share capital of Shangri-La Hotel Limited, Singapore ("SHL") from SHL's independent shareholders and thus increased its interest in SHL to 99.11%. Accordingly, SHL was delisted from the Singapore Exchange Securities Trading Limited on 23 February 2001.

On 2 February 2002, SHL, at an extraordinary general meeting of its shareholders, approved a reduction of its fully paid-up ordinary share capital by 1,476,887 shares. This reduction was confirmed by an order of the Singapore High Court and took effect on 5 March 2002. SHL now is a wholly owned subsidiary of the Company.

2. OPERATIONS REVIEW

Revenue
For the year ended 31 December

	Combined Revenue by Trade				
	2001		Restated 2000		%
	US$ million	%	*US$ million*	%	Change
Hotel Operation	**769.9**	80%	865.9	83%	(11%)
Hotel Management	**8.8**	1%	9.9	1%	(11%)
Property Rentals	**184.6**	19%	171.2	16%	8%
Total	**963.3**	100%	1,047.0	100%	(8%)

Island Shangri-La, Hong Kong - Lobby

Management Discussion & Analysis

Breakdown of Turnover
For the year ended 31 December

	SUBSIDIARIES			ASSOCIATED COMPANIES		
					Restated	
	2001	2000	%	**2001**	2000	%
	US$ Million	*US$ Million*	*Change*	***US$ Million***	*US$ Million*	*Change*
Hotel Operation						
The People's Republic of China						
Hong Kong	**141.0**	161.5	(13%)	**–**	–	N/A
Mainland China	**164.0**	171.0	(4%)	**162.4**	159.5	2%
The Philippines	**74.6**	102.0	(27%)	**–**	–	N/A
Indonesia	**–**	–	N/A	**11.5**	25.9	(56%)
Fiji	**13.8**	11.2	23%	**–**	–	N/A
Singapore	**81.6**	91.8	(11%)	**21.4**	24.5	(13%)
Malaysia	**62.8**	75.4	(17%)	**–**	–	N/A
Thailand	**31.8**	38.1	(17%)	**–**	–	N/A
Myanmar	**5.0**	5.0	0%	**–**	–	N/A
	574.6	656.0	(12%)	**195.3**	209.9	(7%)
Hotel Management	**8.8**	9.9	(11%)	**–**	–	N/A
Hotels Sub-total:	**583.4**	665.9	(12%)	**195.3**	209.9	(7%)
Property Rentals						
The People's Republic of China						
Mainland China	**4.1**	4.0	3%	**158.0**	143.1	10%
Singapore	**7.8**	8.6	(9%)	**7.5**	7.6	(1%)
Malaysia	**3.8**	4.5	(16%)	**2.9**	2.7	7%
Thailand	**0.5**	0.7	(29%)	**–**	–	N/A
Properties Sub-total:	**16.2**	17.8	(9%)	**168.4**	153.4	10%
Total	**599.6**	683.7	(12%)	**363.7**	363.3	0%

Note:
Revenue of the hotel management group is stated after elimination of revenue earned from fellow subsidiaries.

(a) Combined Revenue

Hotels

The People's Republic of China ("PRC")

Hong Kong

Combined revenues of the two hotels in Hong Kong declined by 12.7% in 2001 following a weighted average decline of 15% in room yields ("RevPAR"). Weighted average occupancies declined by 14 percentage points in 2001, triggered by the recessionary trends in the key demand generating countries. The outlook for 2002 points to a gradual improvement in RevPAR in the second half of the year, contingent upon a revival of global economic activity.

Mainland China

Combined revenues of the hotels decreased marginally by 1.2% over 2000, consistent with a 3% decline in the weighted average RevPAR of these hotels in 2001. While most hotels recorded declines in RevPAR, Shangri-La Hotel, Changchun, Pudong Shangri-La, Shanghai and The Kerry Centre Hotel, Beijing recorded double-digit percentage increases in their RevPAR. Overall, weighted average transient rates increased by 7% in 2001 but this was offset by a 5 percentage point decrease in weighted average occupancies. Most hotels achieved average room rate increases in 2001.

PRC nationals continue to form a significant component of the demand for the Group's hotels, ranging from 23% to a high of 90% in select hotels. This segment is expected to maintain a steady growth rate with stability in economic growth forecast and the country's admission to the World Trade Organization in 2001.

Singapore

Combined revenues of the three hotels in Singapore recorded a decline of 11.1% in 2001. Weighted average occupancies declined by 8 percentage points while weighted average RevPAR declined by 13%. During the year, renovations were completed at Shangri-La's Rasa Sentosa Resort, Singapore.

The Philippines

The continuing weakness in the value of the Peso, the perceived security problems in the country and a lack-lustre investment climate depressed business conditions at the Group's hotels. The Makati Shangri-La, Manila commenced major renovations of its guestrooms. This is expected to be completed in the third quarter of 2002. All these factors taken together, drove combined revenues of the Group's hotels down by 26.8% in 2001. Weighted average RevPAR for these hotels declined by 21%.

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Malaysia

Combined revenues of the Group's hotels declined by 16.6% in 2001, in the context of a decline in weighted average RevPAR by 11%. Business at the Group's resort hotels was adversely affected by the drastic curtailment of long-haul travel into Malaysia due to local economic problems and the tragic and unfortunate incidents on 11 September 2001 in the United States of America ("USA"). The Group's city hotel in Penang suffered principally from the contraction in the high technology manufacturing sector in Penang. Renovations were completed at Shangri-La's Golden Sands Resort in Penang. The Shangri-La Hotel, Kuala Lumpur commenced major renovations of its lobby, restaurants and guestrooms in August 2001. This renovation is expected to continue into the second half of this year.

Shangri-La's Rasa Sayang Resort, Penang - Exterior

Thailand

Revenues at the Shangri-La Hotel, Bangkok declined by 16.5% in 2001, following a 10% decline in RevPAR. The hotel commenced major renovations to its lobby, restaurants, public areas and guestrooms in July 2001. The renovation is being done in phases and is expected to be completed in early 2003.

Indonesia

Despite the re-opening of the Shangri-La Hotel, Jakarta on 17 March 2001 after the illegal occupation by some members of the employee's union, the performance of the hotel continues to suffer on account of the political and economic problems facing Indonesia which have curtailed international business travel into Jakarta. The hotel recorded a 55.4% decline in revenues in 2001.

Fiji

With a gradual return to normalcy in the local political situation, the Group's hotels experienced improvement in occupancies from April 2001. However, average rates declined by 18% on a weighted average basis over 2000. Combined revenues increased by 22.9% in 2001. Currently, occupancies continue to remain at healthy levels and it is expected that average rates will show improvement in the latter half of 2002.

Myanmar

The hotel in Yangon maintained its revenues at the same level as in 2000 with occupancy remaining virtually unchanged. The political situation in Myanmar continues to inhibit the hotel's performance.

Hotel Management

Revenues of SLIM International Limited ("SLIM"), the hotel management arm of the Group, before consolidation adjustments, declined by 9% caused by the drop in revenues and operating profits of the underlying hotel portfolio. This caused operating profits before consolidation adjustments to fall by 39%.

Investment Properties

The Group's principal investment properties are located in the PRC and these investments are held through associated companies. A substantial part of this investment portfolio is located in Beijing and Shanghai. Yields at offices and commercial properties registered increases ranging from 5% for office space at the Shanghai Kerry Centre to 108% for the Phase II offices at the China World Trade Center. However, yields at serviced apartments experienced declines ranging from 7% to 16%. Occupancies for commercial and office space are averaging between 75% and 98% respectively, and those for serviced apartments around 70%. The investment properties continue to command premium rentals in the market owing to their location, quality and mix of the facilities and their management.

Lease renewals for commercial and office space are generally continuing to take place at improved rates on expiry of leases. However, the market for serviced apartments continues to remain competitive, in the context of additions to available supply.

Recessionary trends in Singapore caused yields to decline by approximately 10% for the serviced apartments and residences and around 4% for commercial spaces. Occupancies, though, continue to remain at healthy levels ranging from 82% for serviced apartments to 94% for commercial space.

The commercial and office space in the Chao Phya Tower in Bangkok continued to suffer declining yields of 6% and 48%, respectively.

The Group's investment properties in Kuala Lumpur also experienced declines in yields of 10% for serviced apartments and 18% for the office portfolio.

(b) Financial Results

As set out in the following statement, the profit before non-operating items declined marginally by 2% in 2001 to US$90.0 million. This was largely due to the better operating performance by business units in Mainland China relative to those elsewhere and a savings in net interest expenses on corporate borrowings of US$17 million.

Non-operating charges for the year on properties and development projects amounted to US$24.5 million (after share of minority interests) and on other investments US$23.4 million (after share of minority interests). There was a net credit arising from amortisation of negative goodwill of US$16.7 million.

During the year, the Company changed its accounting policy as regards treatment of goodwill in compliance with SSAP 29 and SSAP 30 issued by the Hong Kong Society of Accountants. Details are set out in note 1 to the accounts. This change in accounting policy which was applied retroactively, has resulted in an increase in the profits attributable to members of the Group by US$14.7 million for 2000, after restatement of that year's results.

Management Discussion & Analysis

Consolidated Profit Attributable to Shareholders
For the year ended 31 December

	2001 **US$ million**	Restated 2000 *US$ million*	% *Change*
Company & Subsidiaries			
Hotel Operation			
The People's Republic of China			
Hong Kong	**29.7**	39.1	(24%)
Mainland China	**28.8**	25.2	14%
The Philippines	**14.1**	22.7	(38%)
Singapore	**18.9**	18.3	3%
Malaysia	**2.5**	5.0	(50%)
Thailand	**7.3**	8.9	(18%)
Fiji	**1.4**	0.4	220%
Myanmar	**(2.3)**	(1.8)	(30%)
	100.4	117.8	(15%)
Property Rentals			
Mainland China	**1.2**	1.2	0%
Singapore	**2.3**	2.3	0%
Malaysia	**0.6**	1.2	(50%)
Thailand	**0.1**	0.2	(50%)
	4.2	4.9	(14%)
Hotel Management	**5.7**	11.0	(48%)
Associated Companies			
Hotel Operation			
Mainland China	**14.7**	9.8	50%
Singapore	**0.9**	0.4	125%
Indonesia	**(1.2)**	0.3	NM
	14.4	10.5	37%
Property Rentals			
Mainland China	**23.8**	19.0	25%
Singapore	**0.3**	0.1	200%
Malaysia	**0.3**	0.2	50%
	24.4	19.3	26%
Operating Profit After Tax	**149.1**	163.5	(9%)
Less:			
– Corporate expenses net	**(6.9)**	(2.2)	(214%)
– Net interest expenses on corporate borrowings	**(52.2)**	(69.2)	25%
Profit before Non-Operating Items	**90.0**	92.1	(2%)
Non-Operating Items:			
– (Deficit)/surplus on valuation of hotel and investment properties	**(18.5)**	0.8	NM
– Net realised and unrealised losses on other investments and provision for long-term investments	**(23.4)**	(15.8)	(48%)
– Provision for impairment losses on project under development	**(6.0)**	–	NM
– Amortisation of negative goodwill	**16.7**	14.7	14%
Profit attributable to the members of the Group	**58.8**	91.8	(36%)

Notes:
1. Interest expenses of operating units' bank borrowings are included in operating results.
2. All balances stated are net of share of minority interests.
3. Profit of the hotel management group is stated before elimination of revenue earned from fellow subsidiaries and operating results of the subsidiaries are stated before elimination of management fees charged by the hotel management group.

NM: Not Meaningful

3. LIQUIDITY AND FINANCIAL CONDITIONS

In December 2001, the Company repurchased 66,945,522 equity shares in the Company from a wholly owned subsidiary of SHL by private arrangement. These shares were then cancelled on repurchase. Given the depressed market conditions, the Company believes that the timing of the transaction was appropriate. The cancellation of these shares substantially reduces the 'over-hang' which was perceived as being a contributory factor for the depressed prices for the Company's shares. There are yet 13,195,055 equity shares in the Company being held by another subsidiary. It should be pointed out that the subsidiaries in question received these shares in the first place when they injected their shares in certain Shangri-La hotels into the Company in exchange for shares in the Company.

In addition to the above, the Company repurchased a total of 2,758,000 fully paid equity shares during the year on The Stock Exchange of Hong Kong Limited ("HKSE"), all of which have been duly cancelled.

Taking advantage of the liquidity in the banking system, the Group executed the following unsecured bilateral Hong Kong dollars loan agreements with individual banks:

Date	Loan Amount (HK$ million)	Maturity Date
12 December 2001	780	December 2006
18 December 2001	800	December 2006
11 February 2002	500	February 2007
19 February 2002	300	February 2007
19 February 2002	300	February 2009

The Company considers the pricing of these loans to be very attractive. Funds raised were partly used to prepay, subsequent to the year end, US$280 million of the US$500 million maturing debt due in August 2002, with the objective of arbitraging interest on other existing bank loans and for working capital.

On 15 March 2002, the Group executed a new five-year unsecured loan agreement with a consortium of banks in an amount of HK$3,000 million. The all-inclusive cost of this and the bilateral loans with identical maturities described earlier, ranges between 53 to 55 basis points over HIBOR. With this, the Group has sufficient funds and credit lines in place to prepay the remaining US$220 million maturing debt which is due for repayment in August 2002.

These new loans have therefore pushed out loan maturities, benefited the Group in terms of interest arbitrage, hedged currency risk by having a higher component of debt denominated in Hong Kong dollars and provided funding capacity for the Group's development efforts.

The Group has satisfactorily complied with all covenants under its loan agreements.

As at 31 December 2001 the Group's net borrowings (net of cash and bank balances of US$103.7 million) stood at US$1,022.4 million (versus US$1,010.3 million as at 31 December 2000) and the net borrowings to shareholders' equity ratio was 35.5% (restated to 34.1% as at 31 December 2000). Bank loans and banking facilities of two subsidiaries amounting to US$35.0 million were secured by charges over the hotel properties in question and other assets of these two subsidiaries with net book values of US$94.5 million. A US$0.7 million

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bank loan of a subsidiary was secured by charges over other investments owned by it with net book values of US$6.9 million.

The analysis of loans outstanding as at 31 December 2001 is as follows:

	Maturities of Bank Loans, Overdrafts and Other Borrowings Contracted as at 31 December 2001				
	Repayment				
(US$ million)	Within 1 year	In the 2nd year	In the 3rd to 5th year	After 5 years	Total
Unsecured					
Corporate bank loans	500.0*	–	447.6	–	947.6
Project bank loans and overdrafts	94.9	5.2	24.7	1.8	126.6
Floating rate notes	–	–	16.2	–	16.2
	594.9	5.2	488.5	1.8	1,090.4
Secured					
Project bank loans and overdrafts	24.9	–	10.8	–	35.7
Total Borrowings	619.8	5.2	499.3	1.8	1,126.1
Undrawn but Committed facilities					
Bank loans and overdrafts	146.0	2.2	372.4	11.8	532.4

* *Funds for refinancing fully in place after year end.*

Shangri-La's Tanjung Aru Resort, Kota Kinabalu - Aerial View

The currency-mix of the borrowings, and cash and bank balances as at 31 December 2001 is as follows:

(US$ Million)	**Borrowings**	**Cash and Bank Balances**
In US dollars	664.7#	49.3
In Singapore dollars	107.8	3.2
In Hong Kong dollars	302.6	7.8
In Malaysian Ringgit	16.5	1.7
In Renminbi	32.6	20.0
In Thai Baht	–	13.5
In Philippine Pesos	1.9	5.1
In Fiji dollars	–	3.0
In other currencies	–	0.1
	1,126.1	103.7

Of this, US$300 million has been hedged in Hong Kong dollars with the contracts maturing in 2002.

The loans in United States dollars, Hong Kong dollars and Malaysian Ringgit are at variable rates of interest at spreads over LIBOR, HIBOR and Cost of Funds (for Malaysia), respectively. The majority of the loans in Singapore dollars are at fixed interest rates. The loans in Renminbi are at rates specified by The People's Bank of China from time to time.

The Group has also sought to hedge its medium term interest rate risk by entering into HIBOR interest rate swap contracts. As of the date of this report, the Group has contracted an aggregate principal amount of HK$2,340 million one-year contracts at fixed interest rates between 2.525% to 2.67% per annum and HK$4,916 million three-year contracts at fixed interest rates between 3.735% to 5.74% per annum, of which three-year contracts for HK$2,216 million were entered into after the year end. The interest cover continues through December 2005.

The Group executed guarantees in favour of banks for securing banking facilities granted to certain associated companies. The utilised amount of such facilities covered by the Group's guarantees for these associated companies as at 31 December 2001 amounted to US$47.4 million.

The Group has no off-balance sheet funding schemes in place. It has not entered into contracts guaranteeing payments under finance leases nor has it given profit guarantees under its management contracts.

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4. FIXED ASSET VALUATIONS

(a) Fixed Assets values* – by Geographical Area

	2001		2000	
	US$ million	%	*US$ million*	%
The People's Republic of China				
Hong Kong	**718**	16%	745	16%
Mainland China	**1,972**	44%	1,947	42%
Fiji	**64**	1%	71	2%
The Philippines	**537**	12%	562	12%
Singapore	**649**	14%	700	15%
Thailand	**127**	3%	121	3%
Malaysia	**381**	8%	358	8%
Myanmar	**38**	1%	38	1%
Indonesia	**31**	1%	37	1%
Corporate	**1**	0%	1	0%
Total	**4,518**	100%	4,580	100%

* *Including total fixed assets value owned by subsidiaries and the effective interest share of fixed assets value owned by associated companies.*

Shangri-La Hotel, Singapore - Lobby Court

(b) Independent Valuation of Properties

Hotel and Investment Properties

These are stated at professional valuations carried out by the following independent firms of professional valuers:

CB Richard Ellis Limited, DTZ Debenham Tie Leung Limited and Chesterton Petty Limited	:	For properties in the PRC
CB Richard Ellis Limited	:	For properties in the Philippines, Indonesia, Myanmar, Fiji and Thailand
CB Richard Ellis (Pte) Limited, Colliers Jardine Consultancy & Valuation (Singapore) Pte Ltd and DTZ Debenham Tie Leung (SEA) Pte Limited	:	For properties in Singapore
W.M. Malik & Kamaruzaman, CH Williams Talhar & Wong Sdn Bhd and CH Williams Talhar & Wong (Sabah) Sdn Bhd	:	For properties in Malaysia

According to Group practice, independent valuations are obtained on a rotation basis for some of the hotels in its hotel property portfolio each year with the intention that all hotels in its portfolio are independently valued once every three years. Investment properties in its portfolio are independently revalued at every year end. The valuations made in the current year resulted in the reserves decreasing by US$45 million as at 31 December 2001 and a net charge to the current year's results of US$19 million.

5. GOODWILL/NEGATIVE GOODWILL

On adoption of the newly introduced SSAP 29, the US$161 million premium paid under the acquisition of SLIM in the year 1997, which was previously recorded as Intellectual Property Rights in the "Shangri-La", "Traders" and associated trademarks/servicemarks and disclosed as intangible assets, has now been reclassified as goodwill arising from that acquisition and is subject to annual amortisation. Further, on adoption of the SSAP 30 which only became effective during 2001, the premium paid and discount on acquisitions in prior years which was written off or credited directly to the capital reserve has been reclassified as goodwill/ negative goodwill and is amortised using the straight-line method over its estimated useful life of 15 years from the respective dates of acquisition. This change in accounting policy has been applied retrospectively and has resulted in a net credit of US$16.7 million annual amortisation to the profits of this year (2000: US$14.7 million after restatement).

6. ACQUISITIONS

(i) On 25 January 2002, Shangri-La Hotels (Malaysia) Berhad ("SHMB"), a subsidiary of the Company, acquired an additional 25% equity interest in Pantai Dalit Beach Resort Sdn. Bhd. ("PDBR"), the owner of Shangri-La's Rasa Ria Resort and Dalit Bay Golf and

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Country Club in Sabah, Malaysia. Consequently, the Group's effective interest in PDBR, considering that SHL is now a wholly owned subsidiary, has increased from 52.34% to 66.34%.

(ii) On 18 July 2001, a wholly owned subsidiary of SHL entered into a Conditional Shares Sale Agreement to acquire a 40% equity interest in Tanjong Aru Hotel Sdn. Bhd. which owns Shangri-La's Tanjung Aru Resort, Kota Kinabalu in Sabah, Malaysia. Completion of this transaction is conditional upon the receipt of regulatory approvals and waivers which are expected shortly.

(iii) On 23 November 2001, a wholly owned subsidiary of SHL entered into a Sale and Purchase of Shares Agreement for the acquisition of the remaining 40% equity interest in Sentosa Beach Resort Pte Ltd which owns Shangri-La's Rasa Sentosa Resort, Singapore. This acquisition has yet to be completed.

(iv) On 11 March 2002, a wholly owned subsidiary of the Company invested 51% of the registered capital in a newly formed joint venture company, Zhongshan Shangri-La Hotel Co., Ltd., which is developing the hotel in Zhongshan, Guangdong province, the PRC for which the Group signed a management contract on 12 October 2000.

Shangri-La Hotel, Harbin - Banquet Set-up

7. MANAGEMENT STRATEGIES

General

The positive momentum in economic activity experienced by most economies in the region in the latter half of 2000, continued through the first quarter of 2001. Thereafter, recessionary trends in the USA and Europe, in particular the "melt-down" of the technology sector, combined with a spurt in international crude oil prices, triggered a recession in most regional economies. The situation was further exacerbated by the unfortunate and tragic events of 11 September 2001 in the USA which severely curtailed air travel the world over. Security concerns became a major issue influencing travel in general. In particular, arrivals to certain destinations in the region were drastically curtailed after travel advisories were issued by governments discouraging visitations by their citizens to these destinations. This negative sentiment eroded occupancies at the Group's hotels in the region and exerted severe downward pressure on room rates. Consequently, yields at the Group's hotels registered declines in the second half of 2001. In addition, the political situation in Indonesia and the Philippines during the year discouraged new investments in these countries and curtailed business travel sharply.

Amidst all this, the PRC market proved to be relatively stable with the hotels generally suffering only modest declines in yields and with a few experiencing impressive year-on-year growth in yields. The country's admission to the World Trade Organization in late 2001 coupled with the economic growth and political stability that the country continues to enjoy, is a cause for optimism. Domestic travel in the PRC continues to grow strongly. PRC nationals constitute, on average, over 45% of the hotel guests at the Group's hotels in Mainland China.

There are signs that the economy of the USA may soon be coming out of recession. If this comes about and barring any major political problems or international incidents that create fresh security concerns, the second half of this year could experience an improvement in hotels' yields and revenues.

Foreign Exchange Fluctuations

The Group has an economic hedge in terms of currency exposure to the extent that a substantial portion of its hotels' room revenues in Mainland China, the Philippines, Thailand and Indonesia and investment property revenues in Mainland China are priced in United States dollars. Moreover, these and the other hotel revenues in these countries (except Thailand where exchange controls apply) are also immediately converted into United States dollars upon realisation, to the maximum extent possible. The hotels and properties in Hong Kong, Singapore and Malaysia derive their revenues in local currencies.

The Group has entered into currency swap contracts between Hong Kong dollars and United States dollars for US$300 million, to hedge against the Group's loans denominated in United States dollars (please also refer to item 3 foregoing i.e. Liquidity and Financial Conditions).

Apart from the foregoing, the Group has not felt it appropriate to substantially hedge against currency risks through forward exchange contracts after considering the currency risks involved and the cost of obtaining such cover.

Renovation Programmes

Major renovation projects during the year included:

(i) Completion of a renovation programme covering guestrooms and other facilities at Shangri-La's Rasa Sentosa Resort, Singapore.

(ii) Renovation of guestrooms at the Makati Shangri-La, Manila.

(iii) Renovation of lobby, public areas and guestrooms at the Shangri-La Hotel, Bangkok.

(iv) Renovation of lobby, public areas, food & beverage facilities and guestrooms at the Shangri-La Hotel, Kuala Lumpur.

(v) Renovation of guestrooms at Shangri-La's Golden Sands Resort, Penang.

(vi) Renovation of the coffee shop at the Island Shangri-La, Hong Kong.

Of the above, renovations are on-going at the Makati Shangri-La, Manila and Shangri-La hotels in Kuala Lumpur and Bangkok.

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Major renovations to be commissioned in 2002 include the Kowloon Shangri-La, Hong Kong, (guestrooms and public areas), China World Hotel, Beijing (guestrooms and public areas), Valley Wing of the Shangri-La Hotel, Singapore, Traders Hotel, Singapore (guestrooms), Shangri-La's Tanjung Aru Resort, Kota Kinabalu (guestrooms at the Tanjung Wing) and Shangri-La's Mactan Island Resort, Cebu (selected guestrooms).

The Kerry Centre Hotel, Beijing - Presidential Suite

Given the softness in hotel occupancies, the Group believes these renovations are appropriately timed and will result in minimal displacement of revenues. Also, the renovated and upgraded products should be available for sale to coincide with the anticipated turn-round in business conditions in the region. Major renovations commencing in 2002 will be spread over a period of 15 to 18 months. Estimated expenditure on renovations of approximately US$130 million will be largely funded from operating cash flows of the business units, supplemented by locally contracted short-term debt, where appropriate.

Technology

The Group's interactive web-site (www.shangri-la.com) continues to attract increasing volumes of traffic. Reservations over the web-site, albeit very modest, are showing tremendous year-on-year increases (by some 300%). The Company's internal corporate intranet project has made important information such as policies, practices, procedures, minimum quality standards and sharing of ideas, accessible to business managers for their day-to-day decision making.

Shangri-La's Mactan Island Resort, Cebu - Cowrie Cove Restaurant

Personnel

As at 31 December 2001, the Group had approximately 16,500 employees. Salaries of employees are maintained at competitive levels while bonuses are based on an evaluation of efforts and the financial performance of the business units with reference to goals set. Other benefits include provident fund, insurance and medical cover, housing and an Executive Share Option Scheme adopted by the Company on 16 December 1997 (the "Option Scheme"). The Group has extensive training programmes to improve service skills of its line staff and professional skills of other employees. Its in-house training programmes emphasise service attitudes, organizational values and job enrichment. Internal training is supplemented by retaining outside professional training agencies.

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In terms of the Option Scheme, during the year, the Directors granted additional options on 5,340,000 shares to eligible executives of the Group at an exercise price of HK$7.94 per share. The exercise of these new options is governed by a two-year vesting scale. According to the terms of the Option Scheme, options on 6,190,000 shares have so far lapsed. As of this date, the options outstanding aggregate to 26,370,000 shares.

The Shangri-La Hotel in Jakarta experienced an industrial relations problem in December 2000 and was forced to close for business when union employees illegally occupied the hotel premises. The hotel has prevailed in subsequent legal actions in both the Indonesian courts and in parliamentary hearings. The hotel re-opened on 17 March 2001. The Group is actively pursuing constructive dialogue with the union to resolve outstanding employee claims. The Group cares deeply about its employees and its relations with the unions and is looking forward to bringing resolution to this dispute.

New Projects

On 8 July 2001, the Dingshan Garden Hotel in Nanjing, the PRC was rebranded the Shangri-La Dingshan, Nanjing under the management contract signed with the hotel management arm of the Group. This hotel currently has 246 rooms in its inventory. It plans to add another 309 rooms in 2003.

The Group has recently initiated work on the development of hotel projects in Fuzhou and Jingan Nanli in Shanghai. Further, it has acquired land to extend the existing facilities at the Pudong Shangri-La in Shanghai. It has also acquired a 51% equity interest in a new hotel project in Zhongshan (Guangdong province) subsequent to the year end. Incremental investment costs on these projects are projected at US$358 million. The projects are expected to be completed by end 2005, and will be financed partly by locally contracted project loans and partly from corporate funding sources. The Group believes that the opening of these projects will be well timed to benefit from the favourable market conditions expected. The PRC will remain the main focus of the Group's development efforts.

Profit Optimisation

The Group continues to focus on cost reduction efforts. This emphasis has resulted in limiting the decline in gross profit margins to 2% despite a 14% reduction in turnover during the year.

Once there is a sustained upturn in business conditions and a rebound in property values, the Group will consider selling assets that it considers non-core. Funds released will be used to pay down debt and reduce interest expenses.

Management Contracts

On 8 March 2002, the hotel management arm of the Group signed a contract to manage a 555-room resort hotel to be built in Sanya, Hainan Island, the PRC. The hotel is expected to open for business in 2005.

In addition, work on the hotel projects in Zhengzhou, Muscat and Dubai is proceeding on schedule. These hotels should progressively open between 2003 through 2005. The Group has no equity investment in any of these projects.

The Group continues to receive and examine several proposals for management of hotels in the Middle East and in the PRC. These contracts, once implemented, will enhance the brand reputation and improve returns to shareholders of the Company.