



The 75th anniversary of The Peninsula Hong Kong serves as a strong reminder of how unending pursuit of quality and integrity will overcome short-term uncertainties and result in the creation of substantial long-term value.

My first year with the company has been a busy and exciting one, with progress being made in a number of different areas amidst the continuing difficult environment which our businesses face.

Hotel operations

On the hotel side, it has been very pleasing to see our properties maintaining and enhancing their high levels of service, thereby once again gaining much coveted recognition from the industry and our guests. The financial results for our hotels were generally satisfactory for a year which started in the aftermath of the 11 September 2001 terrorist attack and later suffered from further uncertainties caused by the Bali bombing and the threat of war in Iraq.

Our hotels in the Asia-Pacific region performed strongly in 2002, with all the hotels other than The Peninsula Manila achieving increases in both turnover and operating profits. Our flagship hotel, The Peninsula Hong Kong, and The Peninsula Bangkok, which has firmly established itself as one of the leading hotels in that market, both contributed strongly to the increase in operating profits. The shopping arcades in The Peninsula Hong Kong and The Palace Hotel Beijing, which house many of the top retail brand names, continue to perform well.

In the USA, our operating results were somewhat mixed. The Peninsula Chicago, in its first full year of business, has received numerous accolades for the quality of its operation but is still in the process of establishing increased corporate business in a competitive market. The Peninsulas in New York and Beverly Hills both achieved similar revenue per available room (RevPAR) levels to 2001 whilst retaining their strong reputations for quality.

We have continued to work hard during the year to improve the operating margins of our hotel operations. The operating profit margin for all our hotels increased slightly, reflecting the efforts made to contain costs. In addition to the cost saving initiatives taken at the hotel level, we have instigated a number of group procurement projects from which we expect to identify significant savings in our input costs. We are also rolling out a new revenue management programme in order to assist hotels to manage their pricing and inventory more effectively.

Overall, the hotels division increased its revenue and operating profit for 2002 by 14% and 36% respectively to HK\$1,941 million and HK\$305 million.

Property operations

With the bulk of our properties concentrated in Hong Kong, which has continued to suffer from poor economic sentiment, we have faced a challenging environment in our property business. Our largest property asset comprises around 1 million square feet of luxury residential apartments at Repulse Bay where the declining expatriate trends in Hong Kong

have had a significant adverse effect on both occupancy levels and rentals. The office rental market in Hong Kong also continues to suffer, as evidenced by the performance of St John's Building. On the other hand, business has held up well at The Peak Tower and the Peak Tramways, The Landmark in Ho Chi Minh City and the Thai Country Club.

Overall, the revenue and operating profit of the property division fell by 14% and 15% respectively to HK\$410 million and HK\$289 million.

Results and dividends

The company's operating profit increased by 9% from HK\$584 million in 2001 to HK\$637 million in 2002. Total financing charges reduced from HK\$346 million in 2001 to HK\$289 million in 2002, mainly due to a reduction in the average interest rate paid from 6.7% to 5.1%. After taking into account the adjustments from various non-operating items, the profit attributable to shareholders for 2002 amounted to HK\$308 million as compared to HK\$33 million in 2001. This equated to an earnings per share of 26 cents (2001 : 3 cents).

Although the company has achieved a satisfactory increase in both operating profit and profit attributable to shareholders for 2002, the directors consider it prudent to retain a significant portion of the earnings within the company in the light of the group's ongoing capital expenditure requirements as well as the uncertainties arising from the possibility of further conflict in the Middle East. The directors are therefore recommending to shareholders that a dividend of 8 cents per share (2001 : 5 cents per share) be declared out of the earnings of 26 cents per share.

Management

During the year, it was decided to create a Group Management Committee (GMC) to oversee the day to day running of our businesses. The creation of the GMC has provided a forum for more focussed and collective decision-making and the communication between all of our operations and head office has improved as a result. The GMC presently comprises Mark Rhys (Chief Financial Officer), Peter Borer (Group General Manager – Asia), Niklaus Leuenberger (Group General Manager – America), and Martyn Sawyer (Group General Manager – Properties and Clubs), as well as myself.

With all the opportunities and challenges that lie ahead, development and career planning for our key people have been emphasised and we have launched a Group Management Development Programme which is designed to provide accelerated training and work opportunities for our high calibre managers.

Future strategy and developments

We have, during the year, undertaken a strategic review of our businesses to provide a clear direction for our management and operations. We have reaffirmed that our overriding objective is to increase long-term shareholder value whilst preserving and enhancing the quality of service and the Peninsula brand name. In pursuing this overall mission, we have identified five key strategic objectives, which are:

- (i) to develop new hotels and related developments on a measured and prudent basis
- (ii) to maximise the Peninsula brand by purifying its application and using it consistently across hotels and other products where appropriate
- (iii) to explore alternative uses or new concepts as well as any redevelopment potential of our existing assets to seek enhanced returns
- (iv) to devise specific strategies to improve our operating margins, and
- (v) to emphasise career development and training for staff.

We were delighted during the year to have signed an agreement with Mitsubishi Estate Company to develop The Peninsula Tokyo on a prime site in the prestigious Marunouchi business area of Tokyo for opening in 2007. This project represents both a challenge and an opportunity for us to design and build an hotel which we expect to become another flagship for the group and which will incorporate our latest ideas on design and technology.

With the completion of the restructuring of The Palace Hotel Beijing which has given HSH a controlling interest in this hotel, we have embarked on the further phases of a HK\$237 million programme which we expect will bring the standards of The Palace Hotel in line with our other Peninsula products.

Work has recently begun on a HK\$179 million renovation programme for Quail Lodge which upon completion we believe will enhance Quail Lodge's status as a premier golfing and resort destination in the upmarket Carmel area in California.

Besides the major investments described above, we have continued to place emphasis on maintaining and enhancing the quality and value of our existing assets. Guestroom and public area refurbishments continue to take place at a number of our hotels, a new restaurant concept was created in The Peninsula New York and a new Thai restaurant and improved riverside dining are being developed at The Peninsula Bangkok.

On the property side, refurbishments of certain apartments and the clubhouse are taking place at The Repulse Bay. Studies are underway to examine possibilities for the possible redevelopment, reconfiguration or re-theming of certain properties where we think these might add value.

Outlook

Our various operations have reacted positively to the challenges posed by the uncertain market conditions in the past two years and with a number of the hotels showing strong trends towards the end of 2002, we believe that we are in a good position to meet future challenges and deliver satisfactory results. Of course, the threat of disruption from war and terrorism remains and whilst we have maintained our costs to serve the existing healthy business levels, we are well prepared to react quickly in the event that there is significant disruption from such events.

As well as continuing to seek improvements to our operating results through both revenue enhancement and cost efficiency initiatives, we are actively seeking opportunities to create additional value for our shareholders. In 2003, we expect that the much improved products, which we will have at The Palace Hotel and Quail Lodge following completion of their renovation programmes, will be reflected in their results later in the year.

The outlook for the property market in Hong Kong remains weak, although we continue to be positive about Hong Kong's longer-term economic fundamentals and expect a recovery in due course. In the meantime, we are undertaking various studies to explore ways of enhancing the return from our Hong Kong property assets.

As we continue to look towards an uncertain future, it is reassuring to reflect on the recent launch of the celebrations for the 75th anniversary of The Peninsula Hong Kong, which serves as a strong reminder of how the unending pursuit of quality and integrity will overcome short-term uncertainties and result in the creation of substantial long-term value.



Clement Kwok King Man
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