CHIEF EXECUTIVE OFFICER'S REPORT

I am delighted to report a strong set of operating results for 2004 as well as pleasing progress being achieved in our major development projects. In particular, our hotels have enjoyed significant increases in room rates and occupancies during the year.

HOTELS

At the end of 2003, our businesses were still recovering from the aftermath of the SARS outbreak that year. In 2004, this recovery gathered pace and our hotels were able to achieve significant growth in both occupancies and room rates. The average revenue per available room (RevPAR) for the Peninsula hotels in Asia increased by 38% from US$80 in 2003 to US$110, whereas the average RevPAR for the Peninsula hotels in the USA increased by 20% from US$270 in 2003 to US$323.

In Asia, our businesses benefitted from increased economic activity in Hong Kong and China, as well as from the continuing growth of travellers from mainland China and the general resurgence of long haul tourist travel to Asia. The Peninsula Hong Kong recorded its highest annual revenue since 1997 and The Peninsula Palace Beijing continued to benefit from its renovation, increasing room rate by 21% from the previous year. The Peninsulas in Bangkok and Manila and The Kowloon Hotel all performed well above the previous year. Demand from the top fashion brands continues to be strong for prime spaces in our retail arcades in Hong Kong and Beijing, which have occupancies of 93% and 100% respectively.

The sad and devastating tsunami disaster, which occurred just before the year-end, has had relatively little impact on our hotels, although there have been some cancellations in The Peninsula Bangkok. Both our company and our staff responded strongly to the disaster by making donations and helping where possible such as through the provision of free rooms in Bangkok.

In the USA, the strongest growth as compared to 2003 was achieved in New York, with a resurgence of both financial markets activity and visitors to the city. The Peninsula Chicago continued to establish itself as the leading hotel in that city and one of the RevPAR leaders. The Peninsula Beverly Hills increased its average room rate by US$49 to US$466 whilst maintaining over 80% occupancy, despite already being the RevPAR leader in its locale. Performance at Quail Lodge has been disappointing following renovation and therefore re-focussing our market positioning and marketing strategies for the Lodge has been, and continues to be, a high priority.

We have continued to place emphasis on the maintenance and enhancement of the quality of our hotel assets. During the year, enhancement projects successfully completed included the renovations of guestrooms in the original building in Hong Kong, guestrooms in Beverly Hills, The Peninsula Suite in Beijing and the *Pen-Top Bar & Terrace* in New York. The creation of the *Thiptara* restaurant and riverside dining facilities in Bangkok, completed in late 2003, has proved to be highly successful. The renovated guestrooms in The Peninsula Palace Beijing have generated sufficient demand for us to proceed with the final phase of the renovation of the remaining guestrooms, currently under way and due for completion in early 2005.

Of course, service quality to guests is our first priority. Through the warmth, enthusiasm and genuine caring for guests of all our staff in the Peninsula family, our hotels have once again been recognised as being amongst the very best in the world. Many accolades and awards were received during the year, including *Travel + Leisure* magazine naming The Peninsula Bangkok as the second best hotel in the world and the Peninsulas in Chicago and Beverly Hills first and second respectively in North America. The Peninsula Hong Kong won many awards including the No. 1 position in two readers' surveys – the 500 Greatest Hotels in the World, and the World's Best Business Hotels - in *Travel + Leisure* magazine. The calibre of our hotel management team was recognised with all three of our Peninsula general managers in the USA receiving special awards from the industry.

Overall, the hotel division's revenue and EBITDA (earnings before interest, tax, depreciation and amortisation) for the year were HK$2,524 million and HK$658 million, an increase of 28% and 56% respectively as compared to 2003.

NON-HOTEL PROPERTIES AND OPERATIONS

There has been a rebound in the high-end residential lettings market in Hong Kong, with the more bullish property market and increased lettings demand from multinational corporations. This has been reflected in the increase in occupancy of the apartments at 101 Repulse Bay from 75% to 86%. Occupancy has been lower at 109 Repulse Bay due to the ongoing apartment renovation programme, although the strength of demand for the renovated apartments has confirmed both the recent trend of recovery and the appeal of our product.

Our other non-hotel assets, including The Peak Tower, St John's Building, The Landmark in Ho Chi Minh City and the Thai Country Club, have performed solidly for the year. The Peak Tram enjoyed strong growth in patronage, increasing its average daily ridership by 8,471 to 11,222 passengers. Our management of The Hong Kong Club and of other clubs, as well as the Cathay Pacific lounges at Hong Kong International Airport, continues to be highly regarded.

We continue to pursue opportunities to enhance the value of our non-hotel assets. The apartment renovation programme at 109 Repulse Bay will continue in 2005 and the enhancement of the residents' clubhouse has been completed. In December 2004, we unveiled plans for a major redevelopment of The Peak Tower, which we believe will enhance its quality and image, increase the lettable commercial area, and improve visitor access and circulation. Construction of this project will commence in March 2005, from which time the Tower will be closed until its re-opening in mid-2006. We are confident that the "new" Peak Tower will become a dramatic and exciting venue befitting one of the landmarks in Hong Kong.

Overall, the property division's revenue and EBITDA for the year were HK$374 million and HK$260 million, an increase of 1% and 3% respectively as compared to 2003.

FINANCE AND RESULTS

The company's turnover increased significantly as compared to the previous year, at HK$3,112 million (up 24% from 2003). EBITDA (earnings before interest, tax, depreciation and amortisation) increased by 36% to HK$986 million. The profit attributable to shareholders for 2004 was HK$574 million, compared to HK$351 million in 2003, an increase of 64%. This represented earnings per share of 41 cents (2003: 29 cents).

The company's balance sheet has been further strengthened by the retained earnings as well as a surplus arising from property revaluations. As at 31 December, 2004, the company's net assets had increased by 29% to HK$17,384 million and the gearing ratio had declined to 20%. The proceeds from the sale of The Kowloon Hotel, completed in February 2005, will further reduce our gearing level.

Although the business climate has improved markedly, we remain conservative on capital expenditure. Total capital expenditure during 2004, including investment into our new development projects in Tokyo and Shanghai, amounted to HK$360 million, as compared to cash generated from operations of HK$1,042 million, giving rise to net cash inflow before financing of HK$834 million.

An interim dividend of 3 cents per share was paid during the year 2004 (2003: nil). To balance our improved operating performance with our future commitments to the Tokyo and Shanghai hotel projects, the directors are recommending to shareholders that the final dividend be set at 9 cents per share. Together with the interim dividend of 3 cents per share, this represents a total dividend for 2004 of 12 cents per share, which is an increase of 50% over last year. Shareholders will also be given the option to receive their dividend in the form of scrip rather than cash.

New accounting standards bringing Hong Kong in line with international standards came into effect on 1 January, 2005. These will impact the balance sheet and income statement of the group in a number of respects and a further explanation of this is set out in the financial review section of this report.

MANAGEMENT

The composition of the Group Management Committee remains unchanged. Peter Borer was appointed as chief operating officer for The Peninsula Hotels and an executive director of the company in April 2004. He is now charged with responsibility for the overall operations, performance and standards of the Peninsula hotels.

CORPORATE GOVERNANCE

Our commitment to high corporate governance standards is firm. In advance of stock exchange requirements and to adhere to best international practice, the company revamped the Audit and Remuneration Committees, the majority of whose members now comprise independent non-executive directors. In addition, the existing internal audit function was substantially upgraded with the establishment of the audit and risk management department. Its terms of reference, reporting lines and three-year audit cycle plan have been approved by the Audit Committee and a substantial amount of work has already been undertaken.

The company's efforts to enhance its corporate governance practices have been recognised in the results of a survey sponsored by the Hong Kong Institute of Directors and conducted by the City University of Hong Kong in which HSH was named as one of the top ten listed companies for corporate governance in the SAR.

Our 2003 annual report received the Bronze Award in the General Category, in the annual competition conducted by the Hong Kong Management Association. Our report was particularly cited for its transparency, quality of disclosure, analysis, financial highlights and design.

In the Asian Wall Street Journal's annual "AWSJ 200" survey of Asia's leading companies, HSH was placed fourth out of the 10 Hong Kong companies listed. Companies were ranked on reputation (good corporate governance, social, workplace and environmental policies), quality of products and services, management's long-term vision, innovativeness in responding to customer needs, and financial soundness.

STRATEGIES, DEVELOPMENTS AND CORPORATE ACTIVITY

Our group takes a very long-term view on business. Our main strategies, consistent with those set out in the last two annual reports, remain unchanged and are as follows:

1. to continue the development of hotels on a measured basis
2. to purify the Peninsula brand and increase its applications across our hotels and other products

3. to seek ways of enhancing the value of our existing assets through new concepts and redevelopments
4. to improve our operating margins
5. to emphasise career development and training for staff.

On development, The Peninsula Tokyo project remains on track for hotel opening in late 2007. During the year, demolition of the previous Hibiya Park Building was completed and the groundbreaking ceremony for the new hotel was held in October 2004. Designs for the hotel are at an advanced stage and the main construction contractor has been appointed. Our investment cost relates to the fit-out and fixtures, furniture and equipment of the hotel and is estimated at HK$845 million.

The Peninsula Shanghai project is now committed following the signing of the Land Grant contract in October 2004 for the acquisition of a prime site with frontage on to the famous Bund. The proposed development will comprise up to 56,000 square metres of gross floor area and will include a Peninsula hotel of approximately 250 rooms, high-end retail space and a number of luxury serviced apartments. We are presently finalising the building designs to commence construction in 2006 for completion in 2009. The estimated total development cost is approximately HK$2.8 billion. No specific project financing has been raised for the project for the time being.

In order to focus our resources on our core Peninsula brand, the group sold The Kowloon Hotel for a cash consideration of HK$1.93 billion. Completion of the transaction took place on 1 February, 2005. The net proceeds will be used to help fund the development of our new hotels and continuing refurbishment or renovation of some of the group's existing hotel and other property interests. Pending the utilisation of the funds for the above purposes, the proceeds were applied towards reducing bank borrowings and effectively managing the group's cost of funding.

We have also taken steps to strengthen our brand image and applications during the year. The Portraits of Peninsula advertising campaign has made a strong impact for our brand image. Brand applications have included the opening of the Peninsula Boutique in Tokyo and we are in the process of developing a new line of Peninsula Spas. The strength of the Peninsula brand was further reinforced in the independent 2004 Hong Kong Brand Admiration Survey conducted by The Brand Company in which respondents voted The Peninsula as Hong Kong's most admired brand.

Considerable effort and attention continues to be applied towards pursuing opportunities to enhance our existing assets. Major projects now under way include the renovation of The Peak Tower, the continuing renovations of apartments at 109 Repulse Bay, the final phase of room renovations at The Peninsula Palace Beijing and the enlargement of the *Shanghai Terrace* restaurant in The Peninsula Chicago.

After operating for many years as a 40% shareholder in The Peninsula Manila, we decided to extend a partial offer to the local shareholders of the hotel. The offer was declared unconditional on 24 February, 2005, giving the company a 71.68% interest in this hotel. With this increased control over the future direction and management of this hotel, we will be considering possible options to improve the yield of the asset and its market standing and value.

Our margins this year have benefitted significantly from the strong revenue growth. In the hotel division, our EBITDA margin increased from 17% in 2003 to 26%. We continue to seek margin improvements through, among other efforts, economies of scale achieved by disciplined procurement processes and the application of yield management.

On staff development and training, the first Group Management Development Programme was completed in September and already several participants have progressed to more senior positions within the company. Modules One and Two of the Group Professional Development Programme for middle managers within the company are under way, and the first four modules of the Group Front Line Management Development Programme for assistant section heads and front line staff are now being introduced throughout the hotels.

OUTLOOK

The way in which we managed the SARS crisis in 2003 and the resultant strong recovery experienced as a result of our commitment to our investments, our staff and our standards, have reinforced our long-term philosophy towards the ownership and management of hotels. Projects are in hand both to enhance our existing assets in the shorter term and to expand our portfolio in the longer term. However, we continue to be very selective in identifying new hotel development opportunities, with particular emphasis on prime locations as in the case of our sites in Tokyo and Shanghai.

Although 2005 has started with a positive outlook for our hotel businesses, it will be a challenge for our staff, who have worked so hard to achieve such pleasing results in 2004, to maintain the same level of growth in 2005. There will also be challenges from the opening of competitor hotels in some of our markets and the environment surrounding The Peninsula Hong Kong will continue to be disrupted by railway construction works. To overcome these challenges, we continue to be focussed on maintaining and improving our service standards and the unique Peninsula guest experience.

Although our company has a long history, our current portfolio of hotel properties is relatively young, with many of the hotels either recently opened or recently renovated. We therefore continue to see potential for these hotels to gain market share. We are also paying particular attention to Quail Lodge, which is not currently making a positive contribution to the group's earnings.

The current outlook for the Hong Kong property market is positive and we believe that our present apartment renovation programme at The Repulse Bay has been well-timed to capitalise on the demand for the newly renovated apartments, which will become available in the coming year. Leasing rates on tenancy renewals have continued to improve.

This has been an especially active year for the group. It would be difficult, therefore, to highlight one particular event or achievement that encapsulated the company's values. Rather, I would like to acknowledge the exemplary hard work carried out with commitment, cheerfulness and passion at every level within our corporate family. This work ethic and spirit bodes well for our future prospects.

Clement K M Kwok
1 March 2005