The Group's Financial Statements are compiled in accordance with Hong Kong accounting standards under a set of accounting policies which have been adopted as from 1st January, 2005. The Directors wish to draw the attention of the users of these Financial Statements to the following aspects of these accounting policies:

- Deferred taxation has been provided, at the profits tax rate, in respect of revaluation surpluses on the Group's investment properties which are mainly held in Hong Kong. It is the Directors' position that 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 gain would be capital in nature and such gains are subject to a nil tax rate in Hong Kong. The Directors therefore expect that the provision for deferred taxation in respect of revaluation surpluses for Hong Kong investment properties, amounting to HK$2,407 million as at 31 December 2006, would not materialise.
- Hotel properties (other than shopping arcades and offices within the hotels) and golf courses are stated at cost less depreciation and any provision for impairment, rather than at fair market value. In order to provide shareholders 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 2006, the details of which are set out on pages 57 and 58. If these assets are 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 above), the Group's net assets attributable to shareholders would increase by HK$2,452 million.

In the light of the above, the Directors have provided for shareholders' additional information a calculation of the Group's adjusted net asset value as at 31 December 2006 on the basis set out below:

HK$m		
Net assets attributable to shareholders per audited balance sheet		16,982
Writing back the deferred taxation provision in respect of revaluation surpluses on Hong Kong investment properties		2,407
Adjusting the value of hotels and golf courses to fair market value	3,127	
Less: Related deferred tax and minority interests effects	(675)	
		2,452
Adjusted net assets attributable to shareholders		21,841
Audited net assets per share (HK$)		11.89
Adjusted net assets per share (HK$)		15.29

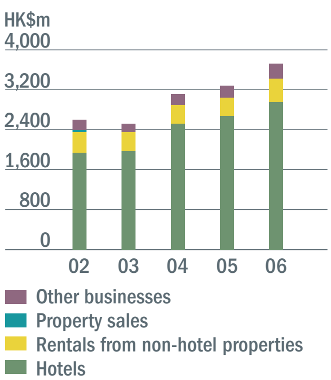
The comparative figure for adjusted net assets as at 31 December 2005 is not meaningful and has not been disclosed as no fair valuation was conducted for hotels and golf courses as at that date.

The Directors believe that the Company's profit and loss account and earnings per share include a number of items which are non-operating and/or non-recurring in nature, such as revaluation surpluses arising on investment properties and the gain on sale of The Kowloon Hotel in 2005. As the Group continues to be managed with principal reference to its underlying operating cash flows and recurring earnings, the Directors have also provided a calculation of the Group's earnings per share excluding non-operating items on the basis set out below:

HK$m	2006	2005
Profit attributable to shareholders	**2,094**	2,664
Net revaluation surplus on investment properties	**(1,189)**	(895)
Net impairment provision adjustments for hotels, golf courses and other properties	**(144)**	(85)
Gain on sale of The Kowloon Hotel	**–**	(991)
Other non-operating items	**–**	(52)
Earnings excluding non-operating items and related tax and minority interests effects	**761**	641
Earnings per share excluding non-operating items (HK$)	**0.54**	0.45

Income Statement

Turnover by activity



Turnover

The total turnover of the Group for the year of HK$3,723 million was 14% above 2005. When comparing year-on-year turnover it should be noted that The Peak Tower was closed for a substantial renovation project in April 2005 and re-opened in phases from July 2006, whilst The Peninsula Manila became a subsidiary of the Company in March 2005, as a result of which its results were consolidated for the first time as from that date, and the hotel was partially closed for renovation works for seven months in 2006.

The underlying 11% increase in turnover from the hotels was a positive performance, most of which was achieved through better yield performance giving rise to increases in average room rates. Positive consumer sentiment fuelled higher domestic patronage at many of our hotels, whilst international business and leisure travel continued to be strong.

With regard to our non-hotel properties, the continued strength of the Hong Kong and China economies resulted in sustained demand for office and residential space, as well as commercial space for high-end retail brands. The rental revenue of HK$464 million represents a 24% increase over 2005.

The table below sets out the breakdown of revenues by business sector and geographical segment:

HK$m	2006		2005	
Hotels				
Rooms	**1,455**	**39%**	1,297	40%
Food and beverage	**813**	**22%**	735	22%
Commercial rentals	**407**	**11%**	377	12%
Others	**275**	**7%**	257	8%
	2,950	**79%**	2,666	82%
Rentals from non-hotel properties				
Residential	**355**	**10%**	295	9%
Office	**42**	**1%**	36	1%
Shopping arcades	**67**	**2%**	43	1%
	464	**13%**	374	11%
Other businesses	**309**	**8%**	236	7%
	3,723	**100%**	3,276	100%
Arising in				
Hong Kong	**1,636**	**44%**	1,411	43%
Other Asia	**887**	**24%**	777	24%
United States of America	**1,200**	**32%**	1,088	33%
	3,723	**100%**	3,276	100%

Hotels During 2006, our majority-owned hotels ("owned hotels") generated total room revenue of HK$1,455 million, representing an increase of 12% over 2005. Food and beverage revenues rose 11% year on year, and commercial rental revenues rose by 8%.

The properties in Asia have enjoyed healthy business. The Peninsula Hong Kong achieved a record year in room revenue, with its average room rate increasing by 12% compared with 2005. In a more challenging environment following the military coup which occurred in September 2006, revenue for The Peninsula Bangkok was 13% ahead of 2005 until August 2006, but only finished 8% ahead for the year as a whole. The Peninsula Beijing achieved an 18% higher average room rate in 2006 and 16% higher revenue. The renovation of The Peninsula Manila disrupted revenue for the year, 2% down from 2005, but the enhanced room product has been warmly received by the hotel's customers and the hotel is looking forward to increased revenue from the renovated rooms.

In the USA, the buoyant market conditions have enabled all our properties to achieve higher room rates. The Peninsula New York maintained its high occupancy levels, with the average room rate 11% above 2005. The Peninsula Beverly Hills continued to lead its market in RevPAR, maintaining high occupancy and achieving record room rates. The Peninsula Chicago also continued to improve its leading RevPAR position compared with its competitive set, whilst gaining top accolades in leading travel surveys. From April 2006, HSH took over direct management of Quail Lodge and restructured the business, with gradually improving results.

Revenues from the hotels' shopping arcades have also increased over 2005 levels, reflecting improved consumer spending in high-end retail.

The breakdown of revenues by property is as follows:

HK$m	2006 Rooms	2006 F&B	2006 Commercial rentals	2006 Others	2005 Rooms	2005 F&B	2005 Commercial rentals	2005 Others
Owned hotels								
The Peninsula Hong Kong	**312**	**291**	**282**	**72**	274	267	259	58
The Peninsula New York	**355**	**91**	**31**	**58**	319	82	29	64
The Peninsula Chicago	**302**	**176**	**–**	**60**	258	156	–	57
The Peninsula Bangkok	**136**	**71**	**2**	**13**	126	66	2	12
The Peninsula Beijing	**211**	**87**	**90**	**21**	178	70	84	21
The Peninsula Manila*	**88**	**60**	**2**	**23**	75	54	1	18
The Kowloon Hotel	**–**	**–**	**–**	**–**	18	7	2	1
Quail Lodge Resort	**51**	**37**	**–**	**9**	49	33	–	7
	1,455	**813**	**407**	**256**	1,297	735	377	238
Managed hotels**								
The Peninsula Beverly Hills	**267**	**95**	**–**	**51**	242	90	–	42
The Peninsula Manila*	**–**	**–**	**–**	**–**	14	11	–	3
	267	**95**	**–**	**51**	256	101	–	45
	1,722	**908**	**407**	**307**	1,553	836	377	283

Notes:

* *In 2005, 10 months' revenue from the Peninsula Manila was consolidated in the Financial Statements of the Group, following the acquisition of a majority share in the hotel. In 2006, 12 months' revenue was consolidated in the Financial Statements of the Group.*

** *Revenue on managed hotels is not consolidated in the Financial Statements of the Group. However, management and marketing fees of HK$19 million (2005: HK$19 million) were received from these hotels.*

Rentals from non-hotel properties Total rental revenue from non-hotel properties was HK$464 million, compared to HK$374 million in 2005. The bulk of the impact of the renovation of the unfurnished apartments at 109 The Repulse Bay was realised from the second half of 2006, following the cycle of rental reversions.

The Peak Tower re-opened in phases from July 2006, after being closed since the end of April 2005. The renovation has added some 30% more lettable space and, with a different market mix, has attracted significantly higher rental rates with 100% occupancy by the year-end. There has been strong demand for the renovated facility.

St. John's Building was fully occupied from March 2006, with a positive increase in overall revenues and unit rates. There has been significant growth in the rates charged for rental space in Central, Hong Kong, and rental revenue increased by 28% over 2005. Occupancy remained high and rates increased further in the office and residential space in The Landmark, Vietnam.

The breakdown of revenues by property is as follows:

HK$m	2006 Residential	2006 Office	2006 Shopping arcade	2005 Residential	2005 Office	2005 Shopping arcade
The Repulse Bay complex, Hong Kong	**344**	**–**	**37**	284	–	36
The Peak Tower, Hong Kong	**–**	**–**	**29**	–	–	7
St. John's Building, Hong Kong	**–**	**23**	**–**	–	18	–
The Landmark, Ho Chi Minh City	**11**	**19**	**1**	11	18	–
	355	**42**	**67**	295	36	43

Other businesses Revenue from the Thai Country Club was 27% above 2005, and the Club received excellent press coverage for the Volvo Masters in December. The Peak Tram enjoyed record breaking annual patronage of 4.43 million people, up 13% from 2005, with revenues 14% higher. Income from the restaurants at The Repulse Bay improved by 13% over 2005, driven largely by an exceptionally high level of banqueting business. The Cathay Pacific Lounges have been operated directly by HSH since June 2006, which has favourably impacted the Peninsula Clubs and Consultancy Services' revenue and profits. Peninsula Merchandising has seen revenues increasing by 59% to HK$27 million over 2005, with increasing revenue derived from Peninsula Boutiques in the hotels and franchised operations in department stores and an airport.

Revenue from other businesses is analysed as follows:

HK$m	**2006**	2005
The Peak Tram	**66**	58
The Repulse Bay restaurants	**62**	55
Cathay Pacific Lounges	**47**	–
Thai Country Club	**52**	41
Quail Lodge golf course	**30**	31
Others	**52**	51
	309	236

Operating costs (%)

Staff costs and related expenses	44
Others	27
Rent and utilities	10
Cost of inventories	11
Depreciation & amortisation	9

Operating costs

Operating costs of HK$2,693 million is 11% above 2005, mainly due to the higher business volumes which have impacted the cost of inventories and led to higher payroll costs in order to service the increased business.

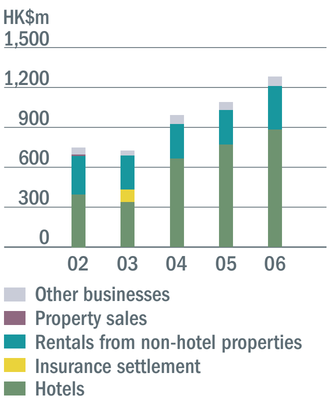
HK$1,181 million or 44% of direct operating costs are payroll-related, up from 42% in 2005. The breakdown of employee numbers at 31 December was as follows:

	2006			2005		
	Direct operations	**Managed operations**	**Total**	Direct operations	Managed operations	Total
Hotels	**4,190**	**411**	**4,601**	3,919	415	4,334
Property	**316**	**–**	**316**	307	–	307
Other businesses	**611**	**393**	**1,004**	377	604	981
	5,117	**804**	**5,921**	4,603	1,019	5,622
Hong Kong	**1,638**	**393**	**2,031**	1,334	604	1,938
Other Asia	**2,414**	**0**	**2,414**	2,316	–	2,316
United States of America	**1,065**	**411**	**1,476**	953	415	1,368
	5,117	**804**	**5,921**	4,603	1,019	5,622

Depreciation

Depreciation during the year was HK$246 million (2005: HK$231 million), largely relating to the hotel properties as explained above. It should be noted that of this figure HK$110 million (2005: HK$101 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.

EBITDA by activity



EBITDA

EBITDA (earnings before interest, taxation, depreciation and amortisation) rose by 17% to HK$1,281 million, with good increases in all divisions. EBITDA can be analysed as follows:

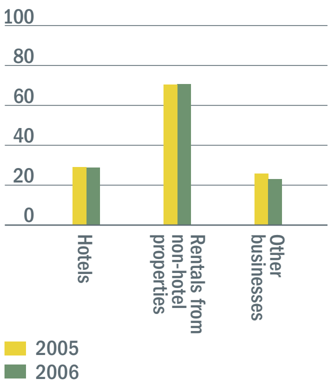
HK$m	Hong Kong	Other Asia	United States of America	Total
2006				
Hotels	**423**	**280**	**179**	**882**
Rentals from non-hotel properties	**310**	**18**	**–**	**328**
Other businesses	**58**	**17**	**(4)**	**71**
	791	**315**	**175**	**1,281**
2005				
Hotels	389	240	140	769
Rentals from non-hotel properties	246	17	–	263
Other businesses	51	13	(4)	60
	686	270	136	1,092

Hotels The hotels division performed strongly as consumer and corporate business volumes remained healthy in all markets. EBITDA for this division increased by 15% to HK$882 million. All hotels showed improved performance compared with 2005. The Peninsula Hong Kong and The Peninsula Beijing both performed strongly as compared to the previous year, whereas The Peninsula Manila increased its EBITDA despite the significant disruption from its renovation programme. The Peninsulas in New York and Chicago benefited from the continued rise in room rates while the loss at Quail Lodge Resort was reduced compared to 2005.

Rentals from non-hotel properties EBITDA arising from rentals in non-hotel properties increased by 25% to HK$328 million, driven largely by increases from residential lettings at The Repulse Bay and increased rentals following the reopening of The Peak Tower. St. John's Building and The Landmark also achieved satisfactory increases.

Other businesses EBITDA from other businesses increased by 18% to HK$71 million, mainly due to increased profit from The Peak Tram, which was positively impacted by the re-opening of The Peak Tower. Other businesses such as the Thai Country Club, Peninsula Clubs and Consultancy Services, Tai Pan Laundry and Peninsula Merchandising performed satisfactorily.

EBITDA margin (%)



EBITDA margin

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

EBITDA margin	2006	2005
Hotels	**30%**	29%
Rentals from non-hotel properties	**71%**	70%
Other businesses	**23%**	25%
Overall profit margin	**34%**	33%
Arising in		
Hong Kong	**48%**	49%
Other Asia	**36%**	35%
United States of America	**15%**	13%

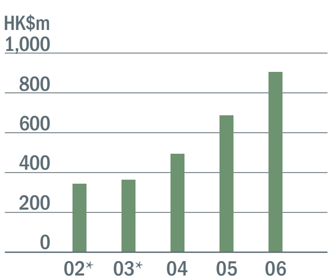
Efforts had been made throughout the year to ensure that operating costs were kept within budget, even as revenues increased above budget, in order to drive as much additional profit into the Group results as possible and compensate for the above inflation increases in some fixed operating and non-operating costs. There have been higher increases in some expenses due to factors outside our control, such as trade union-negotiated pay increases, land use rate increases and energy cost increases.

Margins have improved in most hotels in the Group, except for The Peninsula Bangkok which suffered reduced revenue and increased costs in the last four months of 2006 following the military coup. The margins in The Peninsula Bangkok until August 2006 were in line with 2005, and would otherwise have shown positive growth over a full normal year. The Peninsula Hotels in New York, Chicago, Manila and Beijing were all able to improve their margins over 2005.

Most businesses in the non-hotel properties segment recorded positive improvements in margin performance. Much of the increased turnover in The Repulse Bay complex was in residential revenue, which has a higher profit margin, and resulted in overall improved complex profitability. There was also positive growth in margins in The Peak Tower following its re-opening in July and in St. John's Building, whilst The Landmark maintained its profitability margin.

In the other business segment, the Cathay Pacific Lounges came under the Group's direct operation from 1 June. Although this resulted in more profit to the Group, the profit margin is much lower than other businesses. Without this change, the overall margin for this segment would have also shown positive growth compared with 2005.

Profit before non-operating items



*Figures for 2002 and 2003 are stated on the basis of the Company's old accounting policies, which were changed with effect from 1 January 2005 (with 2004 figures restated).

Profit before non-operating items

Profit before non-operating items grew significantly by 31% against 2005 to HK$904 million. This figure is one of the key measures that reflect the underlying performance of the Group, on which management focuses.

The growth in this profit figure was driven by the strong performance from all business segments across the Group, including hotel operations, commercial leasing, office premises, residential apartments, and other businesses. At the same time, reduction in the debt level led to a decrease in interest expenses, thereby further contributing to the profit growth.

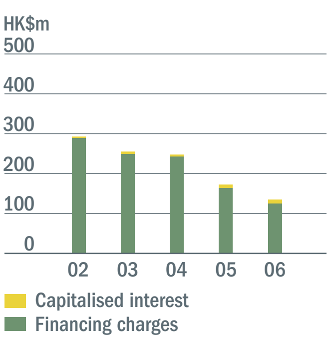
Non-operating items

Fair value changes on investment properties amounting to HK$1,442 million (2005: HK$1,089 million) were mainly attributable to the increase in value of properties in Hong Kong, being the apartments at The Repulse Bay, the shopping arcade at The Peninsula Hong Kong, St. John's Building and The Peak Tower.

The review by the Directors of the fair values and values in use of our hotel properties resulted in a net reversal of some impairment provisions that were previously recognised in the Financial Statements. The net reversal of impairment provisions for hotels, golf courses and other properties totalled HK$200 million (2005: HK$117 million) and arose largely from an increase in value of The Peninsula Chicago, given its strong earnings growth and outlook.

It should also be noted that in 2005, a net gain of HK$953 million was recorded in respect of the sale of The Kowloon Hotel and a gain of HK$60 million was recorded on the sale of land in Phuket. These were one-off transactions that did not recur in 2006.

Financing charges



Financing charges

Financing charges on borrowings in 2006 amounted to HK$134 million, of which HK$9 million was capitalised for The Peninsula Tokyo, The Peninsula Manila and The Peak Tower. The net charge of HK$125 million, which was 23% lower than 2005, was recognised in the income statement. The reduction in financing charges was due to the decrease of 10% in the amount of net borrowings during 2006.

The weighted average gross interest rate for the year remained at 5.0%, the same as in 2005. Interest cover has improved, with operating profit at 8.2 times (2005: 5.2 times) net financing charges for the year.

Taxation

The taxation charge for the year increased as compared to 2005 mainly due to the following reasons:

- The taxation on current year's operating profit increased due to the higher taxable earnings;
- The positive outlook on the availability of future earnings to utilise carried forward tax losses has given rise to further deferred tax credits of HK$43 million (2005: HK$110 million) in respect of unused tax losses, largely arising in the United States; and
- The increases in valuation of investment properties and other fixed assets have resulted in an increased deferred tax expense of HK$305 million (2005: HK$173 million).

The details of the taxation charge are as follows:

HK$m	2006	2005
Taxation on operating profit for the year	**157**	145
Tax adjustments related to prior years:		
Recognition of prior years' tax losses	**(43)**	(110)
Under-provision of current tax liabilities	**4**	–
Taxation on operating items	**118**	35
Deferred taxation on non-operating items	**305**	173
Taxation in the income statement	**423**	208

The deferred tax provision with respect to the accumulated valuation surplus on investment properties increased to HK$2,556 million, of which HK$2,407 million relates to Hong Kong properties. The Directors consider that the provision for deferred tax liabilities with regard to valuation surpluses on the Group's 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.

Balance Sheet

Non-current assets

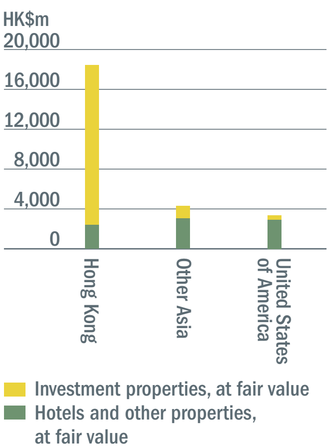
The Group owns and manages eight hotels and resort in Asia and the USA, and is developing two more hotels in Tokyo and Shanghai. The Peninsula Tokyo will open in 2007.

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

Hotel properties (other than shopping arcades and offices at 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. To provide additional information to shareholders 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 2006. An independent valuation was also performed for the Group's investment properties as of 31 December 2006.

Accordingly, a summary of the Group's hotel, investment and other properties showing both the book value and the market value attributable to the Group at 31 December 2006 is set out in the following table:

Valuation



	Total property GFA (sf)	Net lettable area: Shopping arcade (sf)	Net lettable area: Office (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)	Attributable book value (HK$m)
Hotels							
Owned hotels							
The Peninsula Hong Kong *Lease Expiry Jan-2072*	781,499	72,292	59,866	7,772	100%	7,772	6,257
The Peninsula New York *Lease Expiry Aug-2078*	305,870	7,574	–	1,743	100%	1,743	911
The Peninsula Chicago *Freehold/Leasehold*	403,219	–	–	1,322	92.5%	1,223	1,187
The Peninsula Bangkok *Freehold*	732,544	3,246	–	823	75%	617	621
The Peninsula Beijing *Lease Expiry Nov-2033*	790,902	78,703	–	2,020	42.13%	851	569
The Peninsula Manila *Lease Expiry Dec-2027*	921,203	10,473	–	326	76.09%	248	190
Quail Lodge Resort *Freehold*	1,664,460	–	–	165	100%	165	165
	5,599,697	172,288	59,866	14,171		12,619	9,900
Managed hotels							
The Peninsula Beverly Hills (at net cost)†				466	20%	93	
Total for hotels				14,637		12,712	

† *No fair valuation was carried out for The Peninsula Beverly Hills, which is 20% owned by the Group.*

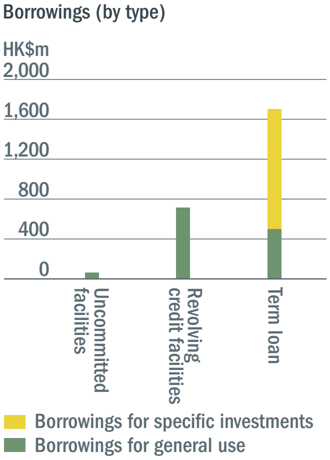
	Total property GFA (sf)	Net lettable area: Shopping arcade (sf)	Net lettable area: Office (sf)	Net lettable area: Residential (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)
Non-hotel properties for rental							
The Repulse Bay *Lease Expiry May-2068*	805,990	26,026	–	376,893	5,633	100%	5,633
Repulse Bay Apartments *Lease Expiry Mar-2071*	710,763	–	–	418,692	3,647	100%	3,647
Repulse Bay Garage *Lease Expiry Sept-2070*	36,438	16,934	–	–	79	100%	79
The Peak Tower *Lease Expiry Mar-2031*	116,546	67,254	–	–	746	100%	746
St. John's Building *Lease Expiry Aug-2114*	103,857	635	60,690	–	463	100%	463
The Landmark *Lease Expiry Jan-2026*	224,922	–	80,439	54,821	76	70%	53
Total for non-hotel properties for rental	1,998,516	110,849	141,129	850,406	10,644		10,621

	Total property GFA (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)
Other properties				
Golf courses				
Thai Country Club *Freehold*	7,405,283	213	75%	160
Quail Lodge Golf Club *Freehold*	5,846,888	35	100%	35
Sub-total for golf courses	13,252,171	248		195
Vacant land				
Vacant land near Bangkok *Freehold*	15,040,030	313	75%	235
Quail Lodge land *Freehold*	15,470,337	80	100%	80
Sub-total for vacant land	30,510,367	393		315
Other properties in use				
Po Yip Building, Flat 2, 1/F *Lease Expiry Jun-2047*	20,594	16	100%	16
1 Lugard Road *Lease Expiry Jan-2077*	4,938	2	100%	2
Sun Hing Industrial Building, Units 1&2, 5/F *Lease Expiry Jul-2120*	4,694	3	100%	3
Sub-total for other properties in use	30,226	21		21
Total for other properties	43,792,764	662		531
Total	**51,390,977**	**25,943**		**23,864**

The revaluation surpluses on investment properties, including the shopping arcades and offices at the hotels, credited to the income statement in 2006, together with the balance of unrealised gains as at 31 December 2006, are summarised below:

Revaluation surplus		**2006**			2005
HK$m	**Surpluses**	**Deferred taxation**	**Minority interests**	**Net surpluses**	Net surpluses
Owned hotels					
The Peninsula Hong Kong	**520**	**(91)**	**–**	429	445
The Peninsula New York	**32**	**(9)**	**–**	23	19
The Peninsula Bangkok	**1**	**–**	**–**	1	1
The Peninsula Beijing	**29**	**(10)**	**(4)**	15	9
The Peninsula Manila	**–**	**–**	**–**	–	–
	582	**(110)**	**(4)**	468	474
Non-hotel properties					
The Repulse Bay complex	**624**	**(109)**	**–**	515	327
The Peak Tower	**137**	**(13)**	**–**	124	49
St. John's Building	**96**	**(17)**	**–**	79	36
The Landmark	**2**	**–**	**–**	2	(1)
	859	**(139)**	**–**	720	411
Vacant land					
Quail Lodge land	**1**	**–**	**–**	1	7
Vacant land near Bangkok	**–**	**–**	**–**	–	3
	1	**–**	**–**	1	10
Total valuation surpluses recognised for the year	**1,442**	**(249)**	**(4)**	1,189	895
Unrealised gains at 1 January				10,179	9,442
Realisation on asset disposal				–	(161)
Exchange differences				–	3
Unrealised gains at 31 December				11,368	10,179

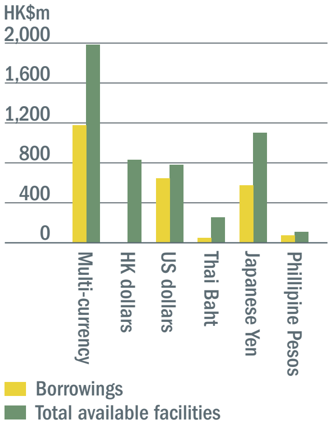
Borrowings (by type)



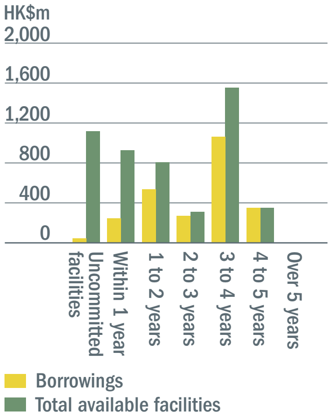
Borrowings

As at 31 December 2006, net borrowings had decreased by 10% as compared to 2005 to HK$2.1 billion due to the operating cashflows and retained earnings generated by the Company. This borrowing level remains well within the debt capacity of the Group.

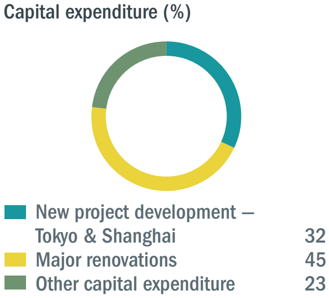
Borrowings and available facilities (by currency)



Maturity profile



Capital expenditure (%)



In addition to the Group's consolidated borrowings, The Peninsula Beverly Hills (20% owned) and The Peninsula Shanghai (50% owned) have obtained non-recourse bank borrowings, which are not consolidated in the balance sheet as the entities owning the assets are not subsidiaries of the Company. Consolidated and non-consolidated borrowings as at 31 December 2006 are summarised as follows:

Borrowings		**2006**			2005
HK$m	**Hong Kong**	**Other Asia**	**United States of America**	**Total**	Total
Consolidated borrowings					
For general use	**1,188**	**118**	**19**	**1,325**	1,535
For specific investments	**–**	**574**	**624**	**1,198**	1,079
Consolidated borrowings	**1,188**	**692**	**643**	**2,523**	2,614
Off balance sheet borrowings attributable to the Group, for specific investments					
The Peninsula Beverly Hills (20%)	**–**	**–**	**117**	**117**	119
The Peninsula Shanghai (50%)	**–**	**15**	**–**	**15**	–
Off balance sheet borrowings	**–**	**15**	**117**	**132**	119
Consolidated and non-consolidated borrowings	**1,188**	**707**	**760**	**2,655**	2,733
Pledged assets attributable to the Group					
For consolidated borrowings	**–**	**–**	**–**	**–**	1,315
For off balance sheet borrowings	**–**	**–**	**264**	**264**	269
	–	**–**	**264**	**264**	1,584

Derivative financial instruments

Derivative financial instruments are generally used to hedge interest rate and exchange rate risks of the Group. Derivative financial assets and liabilities are recorded at their fair value. There is no significant change in the fair value of the derivative financial assets and liabilities during 2006.

Cash Flow Statement

Net cash generated from operating activities increased to HK$1,164 million as compared to HK$1,058 million in 2005. Most of the operating cash flows were applied to capital expenditure and repayment of borrowings.

Capital expenditure in 2006 totalled HK$645 million and is summarised below:

HK$m	**2006**	2005
New project development – Tokyo	**194**	52
– Shanghai	**14**	308
Cash consideration for additional investment – Manila	**–**	12
Major renovations in certain properties	**290**	182
Capital expenditure at other existing properties	**147**	110
	645	664

The Group spent HK$208 million on the developments of The Peninsulas in Tokyo and Shanghai. The development in Tokyo is progressing on schedule and the hotel is expected to open in the second half of 2007. Ground breaking of The Peninsula Shanghai commenced in October 2006, with first-stage financing obtained in December 2006. The second-stage financing is under negotiation with banks and will be finalised in 2007.

Major renovations totalling HK$290 million included redevelopment of The Peak Tower (which was re-opened in July 2006), renovation of guestrooms in The Makati Tower and other areas at The Peninsula Manila (which was completed in December 2006), spa projects at The Peninsulas in Hong Kong, Chicago and Bangkok (which opened in May, June and December 2006 respectively), and the purchase of 14 Rolls-Royce Phantoms in Hong Kong.

In addition, capital expenditure of HK$147 million was incurred on ongoing upkeep and minor capital projects at our existing properties.

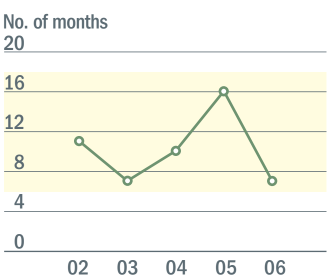
The net cash inflow after interest and dividends before financing activities was HK$232 million for the year, compared to HK$1,928 million in 2005. It should be noted that the figure for 2005 included the sales of The Kowloon Hotel and other fixed assets, exclusive of which the net cash inflow for that year would have been HK$92 million. The increase in the net cash inflow on this comparative basis was mainly due to the improvement in the operating results, as well as reduction in interest expenses.

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.

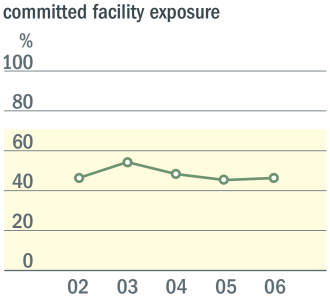
Within the same policy framework, some operating subsidiaries monitor financial risks that are specific to particular transactions within their operations. Associated and jointly-controlled companies arrange their own financial and treasury affairs based on their circumstances on a stand-alone basis.

Financing horizon



Group guideline: 6-18 months

Top 3 banks' aggregated committed facility exposure



Group guideline (≤70%)

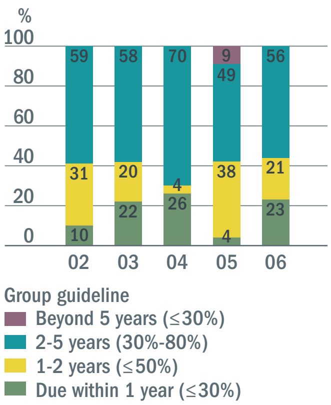
Liquidity risk

The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with loan covenants, and to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments.

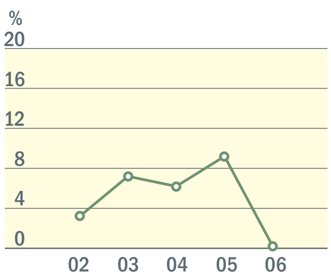
Borrowing requirements are not seasonal as the Group benefits from a steady inflow of income from its leased properties, and there is only minor seasonality in its hotel operations. Borrowing requirements tend to follow the pattern of capital expenditure and investment. As such, the level of borrowing facilities is continuously monitored, at least on an annual basis, to ensure efficient bank facilities management. Appropriate funding action will normally be taken whenever there is any corporate activity with significant cashflow implication. In such circumstances all funding channels will be considered although, debt financing is the Group's main source of funding.

For prudence sake, committed facilities are preferred but uncommitted facilities may be considered where cost savings can be attained. Also, to allow for more flexibility, revolving loans are preferred but term loans may be considered where cost savings are available.

Maturity profile of committed facilities

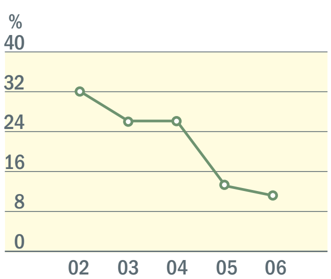


Borrowing facilities with asset pledge



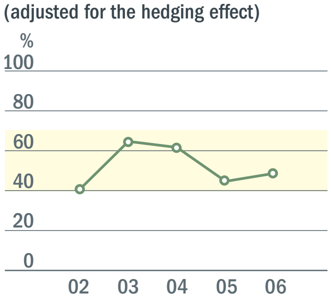
Group guideline (≤20%)

Gearing



Group guideline (≤40%)

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



Group guideline (40%-70%)

In addition, the Group maintains a well-balanced spread of maturities of borrowing facilities, mostly arranged on a medium to long-term basis to minimise the refinancing risk.

Generally speaking, mortgage or pledge of assets is not provided to secure borrowing facilities unless significant cost savings with acceptable risks can be obtained, such as project-based financing.

The Group's policy is that gearing, expressed as the percentage of net borrowings to the total of net borrowings and net assets, shall at all times remain below 40%. Care is taken to ensure that borrowing facilities do not impose onerous or restrictive covenants, and that the terms of the facilities match the underlying requirements. The Group's financial position is reviewed periodically to ensure compliance of loan covenants.

As at 31 December 2006, gearing decreased marginally to 11%, against 13% in 2005.

Interest rate risk

The Group's interest rate risk management policy focuses on reducing the Group's exposure to changes in interest rates. Moreover, under certain circumstances, such as in developing countries, it may be possible to make use of interest rate instruments to reduce the overall interest expenses.

In addition to raising funds directly on a fixed rate basis, the Group may use 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. This policy is subject to periodic review at least once a year.

The interest rates on 51% of the Group's borrowings (including anticipated borrowings that are hedged by interest rate instruments with future effective dates) were fixed on 31 December 2006.

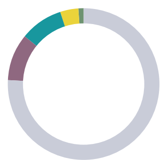
Foreign exchange risk

Significant exposure to movements in exchange rates on individual transactions is monitored and may be hedged by using spot or forward foreign exchange contracts 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.

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.

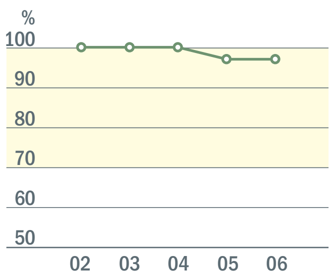
The long-term financial obligations of the Group's entities are normally arranged in currencies in which they have substantial positive operational cash flows, thereby establishing natural currency hedges.

Net assets (%)



HK dollars	76
US dollars	10
Chinese Renminbi	9
Thai Baht	4
Phillipine Pesos	1

Bank deposit at counterparties having credit ratings of at least investment grades



Group guideline (≥70%)

As at 31 December 2006, after accounting for currency hedging, approximately 76%, 9%, 10%, 4% and 1% of the Group's net assets were denominated in Hong Kong dollars, Chinese Renminbi, United States dollars, Thai Baht and Philippine Pesos 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.

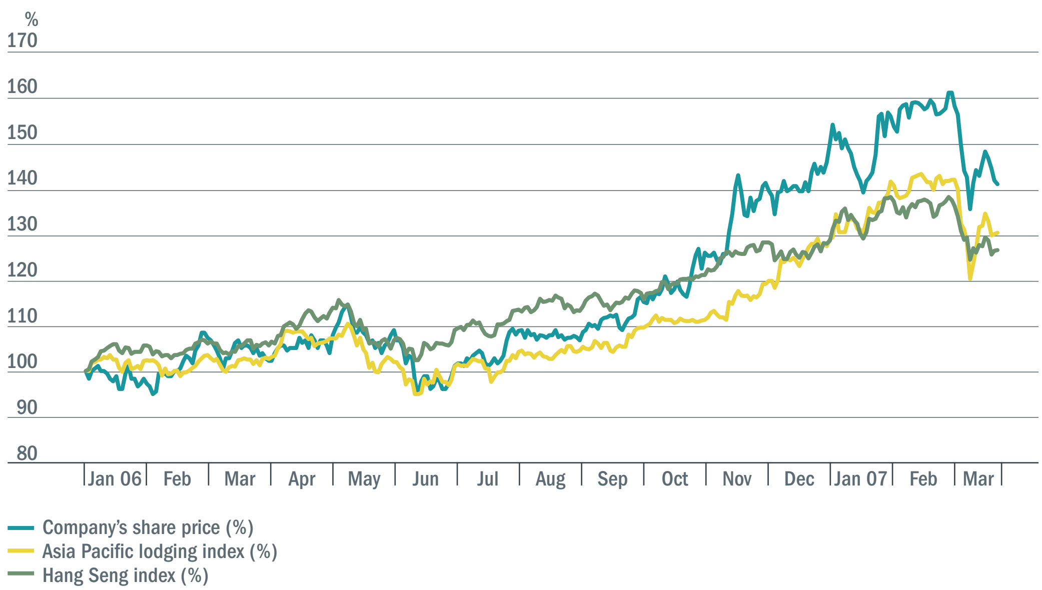
Derivatives are used solely for hedging purposes and not for speculation, and the Group only enters into derivative transactions with counterparties which have credit ratings of at least investment grades, even in developing countries, because of the longer term effect.

Share Information

The Company's share price closed on 15 March 2007 at HK$12.22, giving a market capitalisation of HK$17.5 billion (US$2.3 billion) and reflecting a premium of 3% to net assets attributable to shareholders of the Company. This also represents a discount of 20% to adjusted net assets.

During 2006, the share price outperformed the Hang Seng Index and an index of leading Asia Pacific hotel stocks.

Share price & indices



Note: The share price and indices as at 31 December 2005 = 100%