

## DIRECTORS' REPORT

The Directors have pleasure in submitting their Report together with the audited financial statements for the year ended 31 December 2006.

### PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding and the principal activities of its subsidiaries are the ownership and management of hotel, retail, commercial and residential properties in Asia and the United States of America.

### PERFORMANCE

A discussion and analysis of the Group's performance during the year, the material factors underlying its results and financial position, and details of the Group's principal activities are provided in the Financial Review on pages 48 to 63.

### TEN YEAR FINANCIAL AND OPERATING SUMMARIES

Summaries of the Group's financial and operating data for the last ten years are set out on pages 4 and 64.

### FINANCIAL STATEMENTS

The profit of the Group for the year ended 31 December 2006 and the state of the Company's and the Group's affairs as at that date are set out in the Financial Statements on pages 86 to 147.

### SHARE CAPITAL

On 23 June 2006 and 17 November 2006, pursuant to scrip dividend schemes, the Company issued and allotted 5,903,392 shares and 5,010,424 shares respectively at an issue price of HK\$9.33 and HK\$10.128 each to the shareholders who elected to receive shares of the Company in lieu of cash for the 2005 final and 2006 interim dividends in respect of the year ended 31 December 2005 and the six months ended 30 June 2006, respectively.

All ordinary shares issued rank *pari passu* in all respects with the existing issued shares. Save as described above, there were no other changes in the share capital of the Company. Particulars of the share capital of the Company during the year are set out in note 25 to the financial statements.

### DIVIDENDS

An interim dividend of 5 cents per share was paid during the year 2006. The Directors have recommended a final dividend of 11 cents per share. Subject to the approval by shareholders at the forthcoming Annual General Meeting to be held at The Peninsula Hong Kong on 11 May 2007 at 12 noon, such dividend will be payable on or about 15 June 2007 to shareholders whose names appear on the register of members on 11 May 2007, with a scrip dividend alternative. The register of members will be closed from 8 May 2007 to 11 May 2007, both days inclusive.

To be entitled to receive the final dividend, shareholders must ensure that all transfer documents accompanied by the relevant share certificates are lodged with the Company's registrars, Computershare Hong Kong Investor Services Limited of Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:00 p.m. on Monday, 7 May 2007.

#### PRINCIPAL SUBSIDIARIES

Particulars of the principal subsidiaries of the Company are set out on page 146.

#### FIXED ASSETS

Movements in fixed assets during the year are set out in note 14 to the Financial Statements.

#### CAPITALISED INTEREST

Interest amounting to HK\$9 million was capitalised by the Group during the year as set out in note 4(a) to the Financial Statements.

#### RESERVES

Reserves available for distribution to shareholders and movements in the reserves of the Company and the Group during the year are set out in note 26 to the Financial Statements.

#### PURCHASE, SALE AND REDEMPTION OF LISTED SECURITIES

There was no purchase, sale or redemption of the Company's listed securities during the year.

#### BORROWINGS

Particulars of all borrowings are set out in note 24 to the Financial Statements.

#### CHARITABLE DONATIONS

Donations made by the Group for charitable purposes during the year amounted to HK\$1,163,900.

#### MAJOR CUSTOMERS AND SUPPLIERS

The diversity and nature of the Group's activities are such that the percentage of sales or purchases attributable to the Group's five largest customers or suppliers is significantly less than 30% of the total and the Directors do not consider any one customer or supplier to be influential to the Group.

## CONNECTED TRANSACTIONS

The Board has reviewed all connected transactions of the Company including the following:

### (a) Connected transaction

Under a tenancy agreement commenced on 1 April 2003 and due to expire on 31 March 2007, a wholly owned subsidiary, HSH Management Services Limited, has leased the 7th and 8th floors of St. George's Building, 2 Ice House Street, Central, Hong Kong at a market rate of approximately HK\$469,650 plus service charge of HK\$146,531 (up to September 2006) and HK\$161,560 (from October 2006 onwards) per month from Kadoorie Estates Limited ("Kadoorie Estates"). Details of this transaction were published in the newspapers on 28 March 2003.

Kadoorie Estates acts as an agent for the registered owner, New Cobalt Holding Corporation ("Cobalt"), which is the trustee of a unit trust, the units of which are held ultimately by discretionary trusts. The members of the Kadoorie family are discretionary objects of those discretionary trusts. At 15 March 2007 Bermuda Trust Company Limited ("Bermuda Trust") is deemed to be interested in 54.84% of the issued share capital of the Company and Bermuda Trust is indirectly interested in the said unit trust of which Cobalt is the trustee.

### (b) Continuing connected transaction

The Peninsula Manila is owned by Manila Peninsula Hotel, Inc. ("MPHI" – a 40% associate of the Group prior to 3 March 2005). MPHI became a subsidiary on 3 March 2005 following the completion of an offer made to the shareholders as announced on 29 October 2004. The Peninsula Manila is situated on a piece of land owned by Ayala Hotels, Inc. ("Ayala"), an associate of an MPHI director. Ayala is entitled to receive contingent rental from MPHI based on 5% of the gross income of MPHI pursuant to a land lease contract dated 2 January 1975 with an initial term from 31 December 1975 to 31 December 2001 and as extended to 31 December 2027. The lease became a continuing connected transaction as defined under the Listing Rules following the completion of the offer. An announcement of the continuing connected transaction was made on 8 July 2005. The amount of rent paid to Ayala under the lease from January to December 2006 was HK\$8.8 million.

The Directors, including all the Independent Non-Executive Directors, have reviewed the above continuing connected transaction and confirmed that the transaction:

- (i) was negotiated in 1975, by the management of MPHI at that time, is in the ordinary and usual course of business of MPHI based on normal commercial terms and on arm's length basis; and
- (ii) is beneficial and necessary for the continuation of MPHI's business and is fair and reasonable in the interests of the Company and its shareholders as a whole.

The Company's Auditors have also reviewed the continuing connected transaction described above and confirmed to the Board of Directors of the Company that based on their work performed:

- (i) the transaction had received the approval of the Company's Board of Directors;
- (ii) nothing came to their attention that caused them to believe that the connected transaction was not entered into in accordance with the terms of the related agreement governing connected transaction; and
- (iii) the cap amount (i.e. 5% of the Gross Income of MPHI, as defined in the announcement dated 8 July 2005) was not exceeded during the year ended 31 December 2006.

### MATERIAL RELATED PARTY TRANSACTIONS

Details of material related party transactions which were undertaken in the normal course of business are set out in note 34 to the Financial Statements.

### DIRECTORS

Biographical details of the Directors in office at the date of this report are shown on pages 38 and 39. All the Directors held office for the whole of 2006 with the exception of Messrs. John A. H. Leigh and Nicholas T. J. Colfer who were elected Non-Executive Directors at the Company's Annual General Meeting held on 18 May 2006 to fill the vacancies following the retirement of Sir Sidney Gordon and Mr. James S. Dickson Leach.

In accordance with the articles of association of the Company, The Hon. Sir Michael Kadoorie, Mr. Ian D. Boyce, Mr. Robert C. S. Ng and Mr. Patrick B. Paul will retire by rotation at the forthcoming Annual General Meeting, and being eligible, have agreed to offer themselves for re-election. In addition, Mr. Peter C. Borer was re-elected as a Director at the Company's 2004 Annual General Meeting and will retire voluntarily at the forthcoming Annual General Meeting in accordance with the Company's articles of association, and being eligible, will offer himself for re-election.

None of the Directors to be proposed for re-election at the forthcoming Annual General Meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

### ALTERNATE DIRECTORS

Mr. James S. Dickson Leach ceased to be Alternate Director for The Hon. Sir Michael Kadoorie, Mr. William E. Mocatta and Mr. Ronald J. McAulay following his retirement on 18 May 2006 following the Annual General Meeting.

The Hon. Sir Michael Kadoorie and Mr. William E. Mocatta also ceased to be Alternate Directors following the retirement of Sir Sidney Gordon and Mr. James S. Dickson Leach respectively on 18 May 2006 following the Annual General Meeting.

### SENIOR MANAGEMENT

Biographical details of the senior management at the date of this Report are shown on page 40. They held office for the whole of 2006.

## INTERESTS OF DIRECTORS AND CHIEF EXECUTIVE

As at 31 December 2006, the interests and short positions of each Director and the Chief Executive of the Company in the shares, underlying shares and debentures of the Company or any associated corporations, within the meaning of Part XV of the Securities and Futures Ordinance (“SFO”), recorded in the register required to be kept under section 352 of the SFO, or required pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) to be notified to the Company and the Stock Exchange were as follows:

### *Long position in shares of the Company and its associated corporations*

	Capacity	Number of shares held in the Company	% of the issued share capital of the Company
The Hon. Sir Michael Kadoorie	Note (a)	712,485,318	49.876
Mr. Ian D. Boyce	Beneficial Owner	206,432	0.015
Mr. Clement K. M. Kwok	Beneficial Owner	619,301	0.043
Mr. Ronald J. McAulay	Note (b)	492,806,747	34.498
Mr. William E. Mocatta	Note (c)	1,017,000	0.071
Dr. The Hon. Sir David K. P. Li	Beneficial Owner	516,081	0.036
Mr. Robert C. S. Ng	Family	121,168	0.009
Mr. Pierre R. Boppe	Beneficial Owner	150,000	0.011
Mr. C. Mark Broadley	Beneficial Owner	206,432	0.015
Mr. Peter C. Borer	Beneficial Owner	116,566	0.008
Mr. John A. H. Leigh	Note (d)	367,191,387	25.704

#### Notes:

(a) *The Hon. Sir Michael Kadoorie was deemed (by virtue of the SFO) to be interested in 712,485,318 shares in the Company. These shares were held in the following capacity:*

(i) *421,897,728 shares were ultimately held by discretionary trusts, of which The Hon. Sir Michael Kadoorie is one of the beneficiaries and discretionary objects.*

(ii) *290,587,590 shares were ultimately held by a discretionary trust, of which The Hon. Sir Michael Kadoorie is one of the beneficiaries and the founder.*

*For the purpose of the SFO, the spouse of The Hon. Sir Michael Kadoorie was taken to have a duty of disclosure in Hong Kong in relation to the 712,485,318 shares referred to in (a). The interest disclosed by the spouse of The Hon. Sir Michael Kadoorie is that of The Hon. Sir Michael Kadoorie which is attributed to her pursuant to the SFO for disclosure purposes. Nevertheless, she has no interest, legal or beneficial, in those shares.*

(b) *Mr. Ronald J. McAulay was deemed (by virtue of the SFO) to be interested in 492,806,747 shares in the Company. These shares were held in the following capacity:*

(i) *421,897,728 shares were ultimately held by discretionary trusts, of which Mr. Ronald J. McAulay is one of the discretionary objects.*

(ii) *70,909,019 shares were ultimately held by a discretionary trust, of which Mr. Ronald J. McAulay, his wife and members of his family are discretionary objects.*

(c) *Mr. William E. Mocatta is the founder of a discretionary trust which is the ultimate owner of the 1,017,000 shares.*

(d) *Mr. John A. H. Leigh, in his capacity as one of the trustees of a charitable trust which is one of the ultimate owners of unit trusts which indirectly hold 367,191,387 shares, was deemed to be interested in the 367,191,387 shares.*

Messrs. Robert W. Miller, Patrick B. Paul and Nicholas T. J. Colfer, who are Directors of the Company, have each confirmed that they had no interests in the shares of the Company as at 31 December 2006.

Certain Directors held qualifying shares in Manila Peninsula Hotel, Inc., a 76.09% subsidiary of the Company, on trust for the Company and other subsidiary.

Except as set out above, as at 31 December 2006 none of the Directors and Chief Executive of the Company, or any of their spouses, or children under eighteen years of age, has any interests or short positions in the shares, underlying shares and debentures of the Company or its associated corporations, within the meaning of Part XV of the SFO, recorded in the register required to be kept under section 352 of the SFO, or required pursuant to the Model Code to be notified to the Company and the Stock Exchange.

At no time during the year was the Company, or its subsidiaries or its associated companies, a party to any arrangements which enabled any Director to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or of any other body corporate.

#### INTERESTS OF SENIOR MANAGEMENT

As at 31 December 2006, the interests of the senior management (other than Directors) in the shares and underlying shares of the Company were as follows:

	Capacity	Number of shares held in the Company	% of the issued share capital of the Company
Mr. J. Niklaus Leuenberger	Beneficial Owner	1,500	0.0001
Mr. Martyn P. A. Sawyer	Beneficial Owner	25,676	0.0018

### INTERESTS OF SUBSTANTIAL SHAREHOLDERS

So far as is known to any Director or Chief Executive of the Company, as at 31 December 2006, shareholders (other than a Director or the Chief Executive of the Company) who have an interest or short position in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO, were as follows:

#### *Long position in shares of the Company*

	Capacity	Number of shares held in the Company	% of the issued share capital of the Company
Bermuda Trust Company Limited	Trustee	783,394,337	54.840(i)
The Mikado Private Trust Company Limited	Trustee	712,485,318	49.876(ii)
Bermuda Trust (Cayman) Limited	Trustee	436,508,382	30.557(v)
Acorn Holdings Corporation	Beneficiary	421,897,728	29.534(i)
Lawrencium Holdings Limited	Beneficiary	421,897,728	29.534(i)
Harneys Trustees Limited	Interest of controlled corporation	421,897,728	29.534(v)
Goshawk Investments Limited	Beneficiary	367,191,387	25.704(i)
Guardian Limited	Beneficiary	367,191,387	25.704(i)
Lakshmi Company Limited	Beneficiary	367,191,387	25.704(v)
Merlin Investments Limited	Beneficiary	367,191,387	25.704(v)
Mr. Jason Holroyd Whittle	Beneficiary	367,191,387	25.704(i)
Mrs. Deborah Whittle	Beneficiary	367,191,387	25.704(i)
Mr. Richard Parsons	Trustee	367,191,387	25.704(i)
New Boron Holding Corporation	Trustee	367,191,387	25.704(iii)
New Xenon Holding Corporation	Trustee	367,191,387	25.704(iii)
Lawrencium Mikado Holdings Limited	Beneficiary	290,587,590	20.342(ii)
The Magna Foundation	Beneficiary	290,587,590	20.342 (i)
Mikado Holding Inc.	Trustee	290,587,590	20.342(iv)
Mikado Investments Limited	Interest of controlled corporation/Beneficiary of trusts	290,587,590	20.342(iv)

These interests are duplicated to the extent of 6,881,759,727 shares. The net total of 783,394,337 shares reflects duplication of various Directors' interests as set out in the section "Interests of Directors and Chief Executive" of this Report.

Notes:

- (i) *The 783,394,337 shares in which Bermuda Trust Company Limited was deemed to be interested as a trustee include (1) the 421,897,728 shares in which Acorn Holdings Corporation, Lawrencium Holdings Limited, Goshawk Investments Limited, Guardian Limited, Mr. Jason Holroyd Whittle, Mrs. Deborah Whittle and Mr. Richard Parsons were deemed to be interested; (2) the 290,587,590 shares in which Mikado Investments Limited, The Magna Foundation and Lawrencium Mikado Holdings Limited were deemed to be interested; and (3) the 712,485,318 shares in which The Mikado Private Trust Company Limited was deemed to be interested.*
- (ii) *The Mikado Private Trust Company Limited controlled Lawrencium Holdings Limited and Lawrencium Mikado Holdings Limited and was therefore deemed to be interested in the shares in which such companies were deemed to be interested.*
- (iii) *The 421,897,728 shares in which Acorn Holdings Corporation and Lawrencium Holdings Limited were deemed to be interested as beneficiaries includes the 367,191,387 shares in which New Boron Holding Corporation and New Xenon Holding Corporation were deemed to be interested as trustee.*
- (iv) *The 290,587,590 shares in which Mikado Investments Limited was deemed to be interested as a beneficiary comprises the 290,587,590 shares in which Mikado Holding Inc. as trustee and The Magna Foundation as beneficiary were deemed to be interested.*
- (v) *Harneys Trustees Limited was deemed to be interested in the 367,191,387 shares in which New Boron Holding Corporation and New Xenon Holding Corporation were interested by virtue of having direct control over New Xenon Holding Corporation. Harneys Trustees Limited was also deemed to be interested in another 54,706,341 shares through other controlled corporations. Lakshmi Company Limited and Merlin Investments Limited were deemed to be interested in the shares in which New Xenon Holding Corporation was interested. Bermuda Trust (Cayman) Limited controlled Lakshmi Company Limited and Merlin Investments Limited and was therefore deemed to be interested in the shares in which Lakshmi Company Limited and Merlin Investments Limited were interested.*

Except as set out above, as at 31 December 2006 the Company had not been notified of any substantial shareholder (other than a Director or Chief Executive of the Company) who had an interest or short position in the shares or underlying shares of the Company that were recorded in the register required to be kept under section 336 of the SFO.

#### **INTERESTS OF ANY OTHER PERSONS**

As at 31 December 2006, the Company had not been notified of any persons other than the substantial shareholders who had interests or short positions in the shares or underlying shares of the Company, which are required to be recorded in the register required to be kept under Section 336 of Part XV of SFO.

#### **DIRECTORS' INTERESTS IN CONTRACTS**

No contract of significance to which the Company, its subsidiaries or fellow subsidiaries was a party, and in which a Director of the Company had a material interest, subsisted as at 31 December 2006 or at any time during the year.



#### EMPLOYEE RETIREMENT BENEFITS

Details of the Group's employee retirement benefits are shown in note 30 to the Financial Statements.

#### CORPORATE GOVERNANCE

The Corporate Governance Report is set out on pages 65 to 75.

#### PUBLIC FLOAT

As at 15 March 2007, the latest practicable date, based on information that is publicly available to the Company and within the knowledge of the Directors, at least 25% of the Company's total issued share capital is held by the public.

#### LOAN AGREEMENTS WITH COVENANTS RELATING TO SPECIFIC PERFORMANCE OF THE CONTROLLING SHAREHOLDER

The Company has not entered into any new loan agreements containing any covenant relating to specific performance of the controlling shareholder which is required to be disclosed in accordance with rule 13.18 of the Listing Rules.

#### AUDITORS

The Financial Statements for the year have been audited by KPMG who will retire at the annual general meeting and, being eligible, offer themselves for re-appointment. A resolution for the reappointment of KPMG as Auditors will be proposed at the forthcoming Annual General Meeting.



By Order of the Board  
Christobelle Liao,  
*Company Secretary*  
Hong Kong, 15 March 2007