Financial Review

Key components of the financial statement

The objective of the Financial Statements is to set out the historic financial performance and financial position of the Group. The key components of the Financial Statements are the income statement, the statement of financial position and the statement of cash flows, all of which are inter-related. The information presented in the income statement, the statement of financial position and the statement of cash flows is briefly described below. The Group's summarised Financial Statements are set out in the Financial Review Summary on pages 50 and 51.

Income statement – this analyses the Group's financial performance for the year, showing profitability and comparatives. The income statement of the Group is set out on page 98 and a detailed discussion of the performance of the Group is set out on pages 54 to 63 of this Financial Review.

Statement of financial position – this summarises the Group's assets and liabilities as at the end of the reporting period and how the net assets were funded. The statement of financial position of the Group is presented on page 100 and a detailed discussion of the financial position of the Group is set out on pages 63 to 65 of this Financial Review.

Statement of cash flows – this provides information about the Group's change in financial position, reconciles the Group's reported income to operating cash flows and analyses how cash generated from operations was applied in investing and financing activities during the year. The statement of cash flows of the Group is set out on page 103 and a detailed discussion of the cash flows is set out on page 66 of this Financial Review.

Non-accounting performance indicators and operational statistics

To enable users of the Financial Statements to assess the Group's operating performance in a more comprehensive manner, operating and non-accounting financial performance indicators are included in this Financial Review to supplement the information presented in the Financial Statements. A summary of the key operational statistics of the Group's individual hotels and commercial properties is set out in the Ten Year Operating Summary on pages 94 and 95.

Basis of preparation of the financial statements

The Group's Financial Statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRS"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS") and interpretations. HKFRS are issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") designed for general purpose financial statements. Whilst certain management judgements may be applied when preparing the Financial Statements, the Group is obliged to follow the framework of HKFRS and a set of prescriptive standards under the HKFRS to measure, recognise and record its transactions; and to present and disclose the resultant accounting effects in its Financial Statements without any departures.

During 2010, the HKICPA has issued a number of amendments and new standards and interpretations ("Revised HKFRS"). The Group has adopted all Revised HKFRS which are effective for the year ended 31 December 2010 and the adoption of the same has not resulted in any significant impact on the Group's results of operations and financial position.

The Group has also reviewed the Revised HKFRS that are not yet effective for the year ended 31 December 2010 and concluded that, although the *Amendments to HKAS 12 Income Taxes* (the "Amendments") is effective for annual periods beginning on or after 1 January 2012, the early adoption of the Amendments would better present the Group's deferred tax position as at 31 December 2010. In previous years, deferred taxation had to be provided for

all temporary differences between the carrying amounts of assets and liabilities and their tax bases. Accordingly, the deferred tax liabilities of the Group as at 31 December 2009 included a HK$3,107 million provision, calculated based on the Hong Kong profits tax rate, primarily in respect of revaluation surpluses on the Group's Hong Kong investment properties. Under the Amendments, deferred tax liabilities in respect of the Group's investment properties are now measured with reference to the tax liabilities that would arise if the properties were disposed of at their carrying values at the reporting date, unless the property is depreciable and is held within a business model whose objective is to consume substantially all the economic benefits embodied in the property over time rather than through sale. In view of the foregoing, the Group is no longer required to provide for deferred tax liabilities in respect of temporary differences arising from revaluation of Hong Kong investment properties and the HK$3,107 million deferred tax liabilities in respect of the Group's Hong Kong investment properties were de-recognised retrospectively as a prior year adjustment in the Financial Statements for the year ended 31 December 2010. Further details of the effect on the Group's income statement arising from the early adoption of the Amendments are summarised in note 2 to the Financial Statements.

The Group's adjusted net asset value

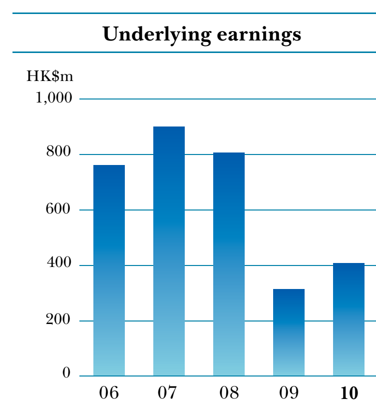
For the purpose of financial statement presentation, the Group has selected the cost model instead of fair value model under the HKFRS as its accounting policy to account for its hotels (other than shopping arcades and offices within the hotels) and golf courses. Under the cost model, hotels and golf courses are measured at depreciated cost less accumulated impairment losses, if any. The fair value model has not been selected in order to avoid the inclusion of unnecessary short term fair value movements in respect of hotel properties and golf courses in the income statement which are considered irrelevant to the underlying economic performance of the hotel and golf course operations. However, in order to provide users of the Financial Statements 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 2010, the details of which are set out on page 64. If these assets were to be 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 Hong Kong hotel properties on the same rationale as noted above), the Group's net assets attributable to shareholders would increase by HK$2,785 million.

In the light of the above, the Directors have provided the users of the Financial Statements with a calculation of the Group's adjusted net asset value as at 31 December 2010 on the basis set out below:

(HK$m)	**2010**		2009 *(restated)*	
Net assets attributable to shareholders per audited statement of financial position		**29,103**		26,147
Adjusting the value of hotels and golf courses to fair market value	**3,151**		2,559	
Less: Related deferred tax and non-controlling interests	**(366)**		(135)	
		2,785		2,424
Adjusted net assets attributable to shareholders		**31,888**		28,571
Audited net assets per share (HK$)		**19.66**		17.79
Adjusted net assets per share (HK$)		**21.55**		19.44

The Group's underlying earnings

The Group's operating results are mainly derived from the operation of hotels and letting of commercial properties. However, to comply with the HKFRS, the Group is required to include non-operating and non-recurring items, such as the increase in fair value of investment properties and impairment provision adjustments for certain assets, in its income statement. As the Group continues to be managed with principal reference to its underlying operating cash flows and recurring earnings, the Directors have provided for the users of its Financial Statements calculations of the Group's underlying profit attributable to shareholders and underlying earnings per share, which are determined by excluding the post-tax effects of the property revaluation movements and other non-operating items, as set out below:

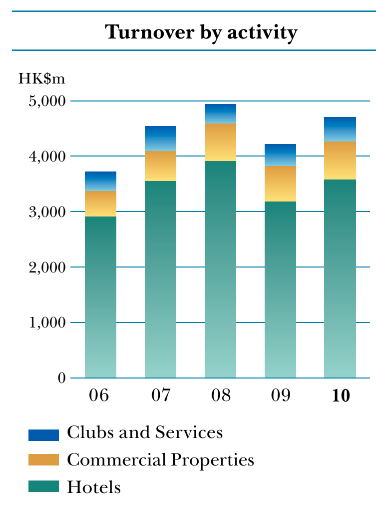


(HK$m)	**2010**	2009 *(restated)*	2010 vs 2009
Profit attributable to shareholders	**3,008**	2,660	13%
Increase in fair value of investment properties	**(1,938)**	(1,998)	
Reversal of impairment losses	**(110)**	–	
Share of net property valuation gain of a jointly controlled entity, net of tax	**(614)**	(315)	
Other non-operating items	**–**	21	
Tax and non-controlling interests attributable to non-operating items	**62**	(45)	
Underlying profit attributable to shareholders	**408**	323	26%
Underlying earnings per share (HK$)	**0.28**	0.22	27%

Income statement

Turnover

The Group's turnover in 2010 amounted to HK$4,707 million, which was HK$489 million or 12% above 2009. The table on the next page sets out the breakdown of consolidated revenues by business segment and by geographical segment:



Consolidated revenues by business segment (HK$m)	2010		2009 (restated)		2010 vs 2009
Hotels					
Rooms	**1,549**	**33%**	1,355	32%	14%
Food and beverage	**1,123**	**24%**	987	23%	14%
Commercial	**567**	**12%**	556	13%	2%
Others	**337**	**7%**	282	7%	20%
Total hotel revenue	**3,576**	**76%**	3,180	75%	12%
Commercial Properties	**688**	**15%**	637	15%	8%
Clubs and Services	**443**	**9%**	401	10%	10%
	4,707	**100%**	4,218	100%	12%

Consolidated revenues by geographical location (HK$m)	2010		2009		2010 vs 2009
Arising in					
Hong Kong	**2,103**	**45%**	1,870	44%	12%
Other Asia	**1,647**	**35%**	1,429	34%	15%
United States of America	**957**	**20%**	919	22%	4%
	4,707	**100%**	4,218	100%	12%

Hotels The Hotels Division generated a total revenue of HK$3,576 million, representing an increase of HK$396 million (12%) over 2009. All hotels experienced increased revenue in 2010 compared with 2009, other than The Peninsula Bangkok whose revenue was at the same level as 2009, which is considered to be a good result in the light of the unstable political situation in Thailand. Although not fully consolidated in the Group results, it is worth noting the strong performance of The Peninsula Shanghai in its first year of operation, with revenue of HK$385 million.

The RevPAR in all the hotels, apart from The Peninsula Bangkok, showed growth in 2010 as compared with 2009. The demand in many of the markets in which we operate has strengthened, with higher occupancies being achieved; however, the growth in average room rates was limited due to keen competition within the competitive set.

Shown below is a breakdown of revenue by hotels:

Breakdown of revenues by hotels (HK$m)	2010 Rooms	2010 F&B	2010 Commercial	2010 Others	2010 Total	2009 (restated) Rooms	2009 (restated) F&B	2009 (restated) Commercial	2009 (restated) Others	2009 (restated) Total	2010 vs 2009
Consolidated hotels											
The Peninsula Hong Kong	**320**	**302**	**379**	**58**	**1,059**	263	285	371	48	967	10%
The Peninsula Beijing	**143**	**77**	**122**	**20**	**362**	101	55	121	18	295	23%
The Peninsula New York	**325**	**99**	**34**	**40**	**498**	289	86	33	33	441	13%
The Peninsula Chicago	**218**	**145**	**–**	**49**	**412**	201	130	–	48	379	9%
The Peninsula Tokyo	**319**	**340**	**27**	**76**	**762**	271	297	26	67	661	15%
The Peninsula Bangkok	**93**	**70**	**3**	**17**	**183**	98	62	3	19	182	1%
The Peninsula Manila	**131**	**90**	**2**	**17**	**240**	101	70	2	17	190	26%
Quail Lodge Resort*	**–**	**–**	**–**	**–**	**–**	31	2	–	2	35	N/A
Management fees income	**–**	**–**	**–**	**60**	**60**	–	–	–	30	30	100%
	1,549	**1,123**	**567**	**337**	**3,576**	1,355	987	556	282	3,180	12%
Non-consolidated hotels											
The Peninsula Shanghai**	**176**	**150**	**34**	**25**	**385**	19	21	8	2	50	670%
The Peninsula Beverly Hills	**260**	**90**	**–**	**46**	**396**	216	78	–	38	332	19%
	436	**240**	**34**	**71**	**781**	235	99	8	40	382	104%

* *Quail Lodge Resort was closed on 16 November 2009.*

** *The Peninsula Shanghai had its soft opening on 18 October 2009 and formally opened on 18 March 2010.*

The Peninsula Hong Kong: Total revenue was HK$92 million (10%) higher than 2009, with marked improvement in revenue from all areas and stable revenue from the Arcade. The hotel's RevPAR was 22% higher than 2009, a result of higher occupancy with noticeable improvement in business from mainland China, USA and Japan. Restaurant and banquet revenues were higher than 2009 as a result of the improved economic environment in Hong Kong.

The Peninsula Beijing: Total revenue was HK$67 million (23%) above 2009, with significant improvement in hotel operations, whilst Arcade rental was maintained at consistent levels with 2009. The competition amongst luxury hotels in Beijing remains intense due to the increased supply and the slow build-up of demand. This situation is expected to continue for some time, resulting in limited opportunity for room rate growth, and forcing the hotel to offer compelling room packages with added value services. Occupancy improved from 34% in 2009 to 46% in 2010, close to the level achieved in 2008, while RevPAR was 42% higher than 2009.

The Peninsula New York: Total revenue was HK$57 million (13%) higher than 2009, with improvement in both occupancy and room rate, as well as food and beverage and Spa revenues. The hotel increased its RevPAR by 12% over 2009 in the improved economic environment. Travel to New York has increased, but there continues to be significant pressure on room rates within the luxury hotel segment. It is well positioned for further growth as the trading environment is expected to improve.

The Peninsula Chicago: Total revenue was HK$33 million (9%) above 2009, as the business base slowly strengthened in Chicago. The hotel's guest mix is almost completely from within North America. The hotel's RevPAR was 9% higher than in 2009, with higher occupancy, but with little increase being achieved in the average room rate. There was significant recognition for the food and beverage business as the hotel's Avenues restaurant was awarded a 2 star award from the Michelin Red Guide.

The Peninsula Tokyo: Total revenue was HK$101 million (15%) higher than 2009. The increased room revenue was due to higher occupancy and rate, with a return of overseas visitors to Japan. There remains significant pressure on the room rate from international travellers because of the strengthening of the Japanese Yen and the resultant higher US Dollar cost for rooms as compared to other destinations.

The Peninsula Bangkok: Total revenue in 2010 was in line with 2009, which is a result of the political instability that has negatively impacted the tourism industry in Thailand. There has been a significant decline in international visitors, especially leisure travellers and heavy price competition across the city. However, local demand was much stronger than that in 2009, with an increased number of banquet functions and 43% higher banquet revenue.

The Peninsula Manila: Total revenue was HK$50 million (26%) higher than 2009. The increased revenue was mainly due to a higher level of occupancy achieved, with a 30% increase in RevPAR and improved food and beverage business. There has been renewed confidence in the Philippine administration following the May 2010 Presidential election, which has led to an improved economic environment. The hotel continued to invest in its food and beverage operation with the successful opening in December 2010 of the Salon de Ning lounge and a new cigar bar.

Across the Group, most of the shops in the hotels' Arcades are leased on terms of two to three years. The Company was successful in its tenant retention efforts in an economically challenging year, resulting in a 2% increase in revenue over 2009.

The operating performances of The Peninsula Shanghai and The Peninsula Beverly Hills are provided below, even though these operations are not consolidated as they are not subsidiaries of the Group.

The Peninsula Shanghai: Total revenue was HK$385 million. Business levels were strong following the hotel's Grand Opening Gala on 18 March 2010 and the hotel also benefited from the World Expo 2010, which was held for six months from May to October 2010. The hotel was able to achieve premium room rates in its first year of operation, comparing favourably against other hotels in the same market segment and ending the year with the highest average room rate and RevPAR in the city.

The Peninsula Beverly Hills: Total revenue was HK$64 million (19%) above 2009, due to higher occupancy, which also contributed to higher food and beverage revenue. The hotel's average room rate was less impacted by the economic downturn than our other hotels in the United States and occupancy increased from 61% to 72% in 2010.

Commercial Properties The total revenue from the Commercial Properties Division was HK$51 million (8%) above 2009, attributed to increased revenue from shopping arcades which offset the reduced revenue from residential and office properties.

Breakdown of revenues by Commercial Properties (HK$m)	2010 Residential Properties	2010 Office	2010 Shopping Arcade	2010 Total	2009 Residential Properties	2009 Office	2009 Shopping Arcade	2009 Total
The Repulse Bay Complex, Hong Kong	**381**	**–**	**124**	**505**	385	–	84	469
The Peak Tower, Hong Kong	**–**	**–**	**103**	**103**	–	–	83	83
St. John's Building, Hong Kong	**–**	**38**	**–**	**38**	–	36	–	36
The Landmark, Ho Chi Minh City, Vietnam	**11**	**28**	**3**	**42**	13	34	2	49
	392	**66**	**230**	**688**	398	70	169	637

The Repulse Bay Complex, Hong Kong: Total revenue was HK$36 million (8%) above 2009. Residential revenue was in line with 2009. The revenue increase was attributed to commercial rental and food and beverage. The high end residential leasing market recovered to pre-crisis levels during 2010, resulting in increased occupancy for the Complex, albeit with lower average rental rates, resulting in residential revenue being 1% below 2009.

The Peak Tower, Hong Kong: Total revenue was HK$20 million (24%) above 2009, based on higher rental revenue from retail tenants. The Sky Terrace saw a 7.5% increase in the number of visitors. Occupancy in the Tower remained above 99%, with the majority of existing tenants renewing their leases upon expiry and where tenants had vacated their premises, replacement tenants were quickly identified with limited disruption to the rental revenue flow.

St. John's Building, Hong Kong: Total revenue was HK$2 million (6%) above 2009, with occupancy averaging 97%. The average rental rates were also 8% higher than the year before.

The Landmark, Ho Chi Minh City, Vietnam: Total revenue was HK$7 million (14%) below 2009, due to intense competition in Ho Chi Minh City.

Clubs and Services Apart from Quail Lodge, all businesses within this Division achieved higher revenue as compared to 2009; the combined revenue was HK$42 million (10%) above 2009.

Breakdown of revenues by individual operations of the Clubs and Services Division (HK$m)	**2010**	2009 *(restated)*
Clubs and Consultancy Services	**115**	102
Peak Tramways	**95**	79
Peninsula Merchandising	**95**	75
Thai Country Club	**58**	52
Quail Golf and Country Club	**47**	64
Tai Pan Laundry	**33**	29
	443	401

Revenue from Clubs and Consultancy Services is mainly generated from the operation of the Cathay Pacific Airways' first and business class lounges at the Hong Kong International Airport, where the revenue is based on the number of passengers utilising the lounges. Passenger flow-through increased 13% during the year, resulting in a 13% (HK$13 million) increase in revenue over 2009. Management fees related to the three Clubs that the Group manages in Hong Kong were in line with 2009 and business levels remained steady. Revenue in 2010 also included fees for consultancy services provided to the Waitanyuan project, which is located beside The Peninsula Shanghai.

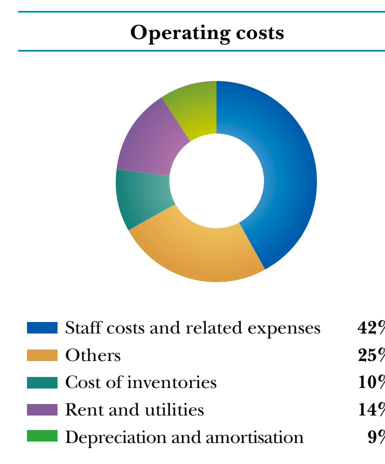
The Peak Tram's patronage rose 11% in 2010, to 5.4 million passengers, the highest record achieved in the Tram's 122 years of history. Revenue increased by HK$16 million or 20% over 2009. For Peninsula Merchandising, revenue was HK$20 million or 27% above 2009. All of the wholesale and retail outlets across Asia recorded revenue growth and stronger trading as compared with 2009, with the more significant increases coming from the outlets in Hong Kong, mainland China and Taiwan.

Total revenue in the Thai Country Club of HK$58 million was HK$6 million (12%) above 2009, due to the stronger Thai Baht; the underlying Thai Baht revenue was in line with 2009. The number of golf rounds was at the same level as 2009, despite the ongoing political tensions in Thailand and reduced number of international visitors.

Total revenue in Quail Lodge Golf and Country Club was HK$17 million (27%) below that of 2009. The hotel portion remained closed and it has been challenging to sell new memberships due to the uncertainty surrounding the future of the golf course and the general economic conditions in California. Total revenue in Tai Pan Laundry was 14% (HK$4 million) higher than in 2009 as a result of the increased business levels in the Hong Kong hotels and other businesses served by the laundry.

Operating costs

Operating costs in 2010 were 8% higher than 2009, compared with the 12% increase in Group revenue. All business operations have continued to exercise various cost control measures in order to improve profit margins. Operations have continued to work with suppliers to find ways to improve on the price of products and services consumed, while operations also focussed on enhancing work efficiency.



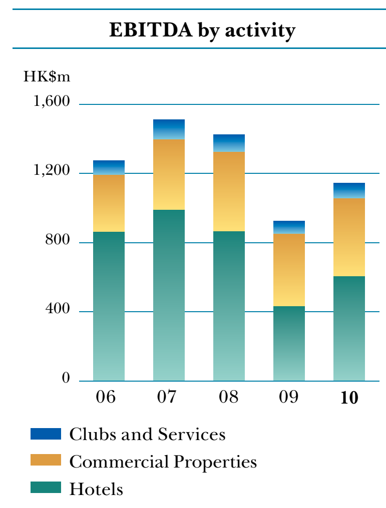
The payroll related costs amounted to HK$1,639 million in 2010, representing 42% of direct operating costs. This cost has increased by 8% over 2009, though the proportion was the same as 2009. The breakdown of full time employee numbers as at 31 December was as follows:

Number of full time employees at year-end	2010 Direct Operations	2010 Managed Operations	2010 Total	2009 Direct Operations	2009 Managed Operations	2009 Total
By division:						
Hotels	**4,391**	**1,135**	**5,526**	4,367	1,122	5,489
Commercial Properties	**339**	**–**	**339**	339	–	339
Clubs and Services	**678**	**412**	**1,090**	605	393	998
	5,408	**1,547**	**6,955**	5,311	1,515	6,826
By geographical location:						
Hong Kong	**1,740**	**412**	**2,152**	1,662	393	2,055
Other Asia	**2,696**	**740**	**3,436**	2,705	760	3,465
United States of America	**972**	**395**	**1,367**	944	362	1,306
	5,408	**1,547**	**6,955**	5,311	1,515	6,826

The number of full time employees has increased by 129 (2%) as compared with 2009. The number of employees has increased primarily because of the increased business levels and the addition of a new Cathay Pacific lounge facility.

EBITDA and EBITDA margin

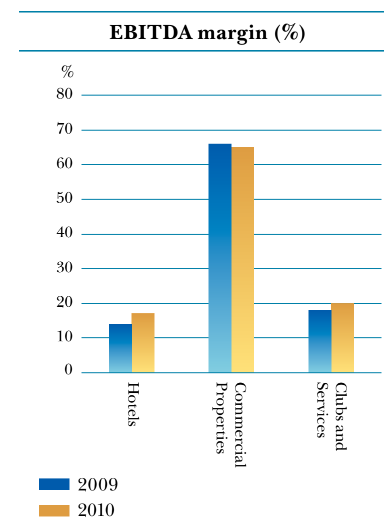
EBITDA (earnings before interest, taxation, depreciation and amortisation) increased by 24% to HK$1,143 million.



EBITDA (HK$m)	Hong Kong	Other Asia	United States of America	Total
2010				
Hotels	**461**	**116**	**27**	**604**
Commercial Properties	**425**	**25**	**–**	**450**
Clubs and Services	**109**	**14**	**(34)**	**89**
	995	**155**	**(7)**	**1,143**
	87%	**14%**	**(1%)**	**100%**
2009 *(restated)*				
Hotels	419	52	(39)	432
Commercial Properties	386	32	–	418
Clubs and Services	81	15	(22)	74
	886	99	(61)	924
	96%	11%	(7%)	100%
Change 2010 vs 2009	12%	57%	89%	24%

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

EBITDA margin	**2010**	2009
Hotels	**17%**	14%
Commercial Properties	**65%**	66%
Clubs and Services	**20%**	18%
Overall EBITDA margin	**24%**	22%
Arising in:		
Hong Kong	**47%**	47%
Other Asia	**9%**	7%
United States of America	**(1%)**	(7%)



The efforts to control costs and staffing levels have resulted in improved profit margins in most of the businesses within our Group, and for the Group in total, as compared with 2009. The margins have, however, reduced in some cases, such as The Peninsula Bangkok where there has been pressure on most cost areas, especially payroll without any growth in revenues. There have also been reduced margins in The Landmark and Quail Lodge because of the reduced revenue in these businesses.

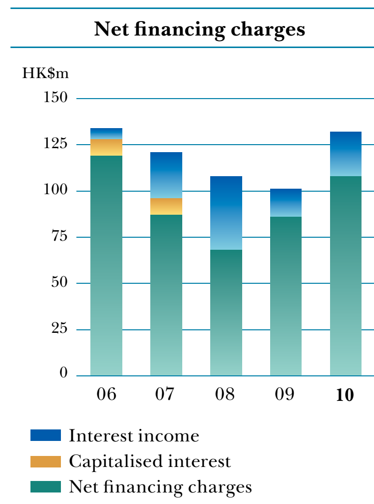
Depreciation and amortisation

The depreciation and amortisation charge of HK$349 million (2009: HK$338 million) largely relates to the hotels. The Group's hotels are subject to a planned maintenance programme in which capital expenditure is incurred on an ongoing basis for refurbishment and improvement. Therefore, depreciation and amortisation normally account for a significant portion of the Group's fixed overheads.

Net financing charges

Financing charges on borrowings in 2010 amounted to HK$132 million (2009: HK$101 million). After netting off interest income of HK$24 million (2009: HK$15 million), a net charge of HK$108 million (2009: HK$86 million) was recognised in the income statement. The 26% increase in net financing charges was mainly due to the increase in borrowings for the funding of working capital of the Group.

The weighted average gross interest rate for the year remained at 3.2% (2009: 3.2%) after accounting for all hedging activities. Interest cover (operating profit divided by net financing charges) increased to 7.4 times (2009: 6.8 times) in 2010, mainly due to the increase in operating profit as a result of the improved operating performance, in particular for the Hotels Division.



Non-operating items

The non-operating items are analysed below:

(HK$m)	**2010**	2009
Increase in fair value of investment properties	**1,938**	1,998
Reversal of impairment losses	**110**	–
Gain on disposal of investment property	**–**	18
Impairment loss on interest in associates	**–**	(15)
Closure costs for Quail Lodge resort	**–**	(24)
	2,048	1,977

The increase in fair value of investment properties for the year was principally attributable to the increase in value for The Repulse Bay Complex and the shopping arcade at The Peninsula Hong Kong. Such increase was a reflection of the improved fundamentals for the Hong Kong property market towards the end of the year, in particular, for luxury residential market and high-end commercial properties.

In accordance with its accounting policy, the Group assessed the recoverable amounts of its fixed assets (other than investment properties) as at 31 December 2010. In view of the significant improvement in the Chicago hotel property, the Directors considered that the impairment provision of HK$110 million previously made against The Peninsula Chicago should be fully reversed to its original cost less accumulated depreciation. The reversal of the impairment provision was determined based on the recoverable amount of the property, being its fair value as determined by an independent professional valuer by reference to the discounted cash flow valuation model of the assets.

Share of profit of a jointly controlled entity

The Group has a 50% interest in The Peninsula Shanghai complex which is owned by a jointly controlled entity. The complex comprises a hotel, a shopping arcade and a hotel apartment tower of 39 units. The hotel and the shopping arcade officiated their grand openings on 18 March 2010 and 1 July 2010 respectively whereas the hotel apartment tower was still under final construction including interior fit-out as at 31 December 2010. The hotel benefited from the successful World Expo 2010 and achieved a gross revenue of HK$385 million with EBITDA margin of 9.4%. The Group's share of profit in relation to The Peninsula Shanghai of HK$526 million (2009: HK$285 million) was inclusive of a post-tax non-operating gain of HK$614 million arising from the property valuation adjustments (2009: HK$315 million).

The jointly controlled entity has loan facilities with Standard Chartered Bank and Agriculture Bank of China to totalling RMB2,335 million, of which RMB2,117 million was drawn as at 31 December 2010. 21% of the loans has interest rate fixed for at least 1 year.

Taxation
The breakdown of the taxation charge is as follows:

(HK$m)	**2010**	2009 *(restated)*
Current tax	**140**	120
Deferred tax:		
Increase/(decrease) in net deferred tax liabilities relating to revaluation of overseas investment properties	**26**	(46)
Increase in net deferred tax liabilities relating to other temporary differences	**59**	22
Net tax charge in the income statement	**225**	96

The increase in current tax and deferred tax in respect of other temporary differences was mainly due to the increase in operating profit and accelerated tax depreciation in respect of capital expenditure incurred in 2010.

During 2010, the fair value of the Group's investment properties increased by HK$1,938 million (2009: HK$1,998 million), of which HK$1,852 million (2009: HK$2,144 million) was attributable to investment properties in Hong Kong. As a result of the early adoption of the *Amendments to HKAS 12 Income Taxes*, provision for deferred tax in respect of valuation gains on Hong Kong investment properties is no longer required.

The 2009 comparative figure in relation to deferred taxation on non-operating items has, therefore, been restated from a net tax charge of HK$308 million to a net tax credit of HK$46 million, and the increase in net deferred tax liabilities relating to other temporary differences has been restated from HK$30 million to HK$22 million.

Statement of financial position

Fixed assets
The Group has interests in and manages nine operating hotels in Asia and the USA and is developing a hotel in Paris, in which the Group has a 20% interest.

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

According to the Group's accounting policies, hotel properties (other than shopping arcades and offices within the 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. In order to provide users of the Financial Statements with additional information 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 2010. At the same time, an independent valuation was also performed for the Group's investment properties in accordance with the accounting policies.

A summary of the Group's hotel, investment and other properties showing both the book value and the market value as at 31 December 2010 is set out in the following table:

	Group's Interest	Market Value (HK$m)	Book Value (HK$m)
Hotels			
Consolidated hotels			
The Peninsula Hong Kong	100%	**10,049**	**8,088**
The Peninsula Beijing	42%	**1,799**	**1,354**
The Peninsula New York	100%	**1,477**	**1,068**
The Peninsula Chicago	100%	**1,233**	**1,188**
The Peninsula Tokyo	100%	**1,602**	**1,260**
The Peninsula Bangkok	75%	**805**	**902**
The Peninsula Manila	77%	**317**	**307**
		17,282	**14,167**
Jointly controlled entity ***(value attributable to the Group)***			
The Peninsula Shanghai	50%	**3,051**	**3,012**
Total for hotels		**20,333**	**17,179**
Commercial Properties			
The Repulse Bay	100%	**8,425**	**8,425**
Repulse Bay Apartments	100%	**5,241**	**5,241**
Repulse Bay Garage	100%	**87**	**87**
The Peak Tower	100%	**1,082**	**1,082**
St. John's Building	100%	**697**	**697**
The Landmark	70%	**92**	**92**
Total for commercial properties		**15,624**	**15,624**
Other properties			
Thai Country Club golf course	75%	**246**	**247**
Quail Lodge resort, golf course and vacant land	100%	**153**	**155**
Vacant land near Bangkok	75%	**348**	**348**
Other Hong Kong properties	100%	**49**	**29**
Total for other properties		**796**	**779**
Total		**36,753**	**33,582**

Interest in a jointly controlled entity

The balance of HK$1,374 million as at 31 December 2010 (2009: HK$815 million) represented the Group's 50% indirect interest in The Peninsula Shanghai Waitan Hotel Company Limited, a wholly-owned foreign enterprise incorporated in the People's Republic of China and which owns 100% of The Peninsula Shanghai. The increase in balance was mainly due to the Group's share of HK$526 million profit (2009: HK$285 million) of this jointly controlled entity during 2010. As explained above, this profit figure includes a post-tax non-operating gain of HK$614 million (2009: HK$315 million).

Interest in associates

The balance of HK$494 million as at 31 December 2010 (2009: HK$498 million) represented the Group's 20% equity interest and 20% share of the related shareholder's loan in Al Maha Majestic S.à r.l., a company incorporated in Luxembourg which indirectly owns a 100% interest in a property in Paris to be redeveloped into The Peninsula Paris hotel. This hotel will be managed by the Group upon completion of the redevelopment, expected to be in 2013.

Investment in hotel management contracts
As at 31 December 2010, investment in hotel management contracts amounted to HK$684 million (2009: HK$730 million). The balance included an attributed consideration of Euro 57.7 million in respect of the right acquired to manage The Peninsula Paris to be developed jointly by the Group and its associate, Al Maha Majestic S.à r.l.. The decrease in the balance was mainly due to exchange rate adjustment on retranslating the Euro currency at the year end.

Borrowings
During the year, gross borrowings increased by 13% to HK$4,332 million (2009: HK$3,825 million) whereas consolidated net borrowings decreased to HK$1,674 million (2009: HK$1,990 million), taking account of cash of HK$2,658 million (2009: HK$1,835 million). The reduction in net borrowings was mainly due to the increase in operating cashflows resulting from the improved operating performance of the Hotels Division.

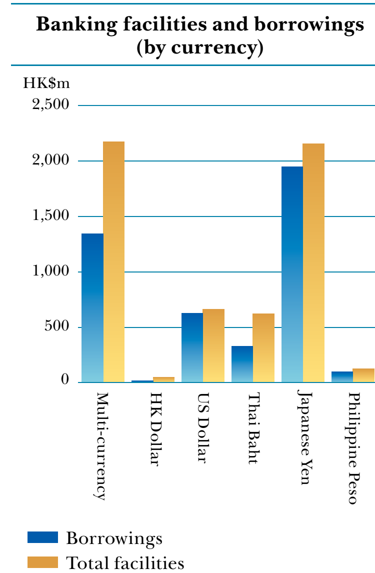
In addition to the Group's consolidated borrowings, The Peninsula Shanghai (50% owned) and The Peninsula Beverly Hills (20% owned) have non-recourse bank borrowings, which are not consolidated in the statement of financial position as the entities owning the assets are not subsidiaries of the Company. The consolidated and non-consolidated borrowings as at 31 December 2010 are summarised as follows:

	2010				2009
(HK$m)	Hong Kong	Other Asia	United States of America	Total	Total
Consolidated gross borrowings	**1,348**	**2,359**	**625**	**4,332**	3,825
Non-consolidated borrowings attributable to the Group*:					
The Peninsula Shanghai (50%)	**–**	**1,253**	**–**	**1,253**	930
The Peninsula Beverly Hills (20%)	**–**	**–**	**218**	**218**	218
Non-consolidated borrowings	**–**	**1,253**	**218**	**1,471**	1,148
Consolidated and non-consolidated gross borrowings	**1,348**	**3,612**	**843**	**5,803**	4,973

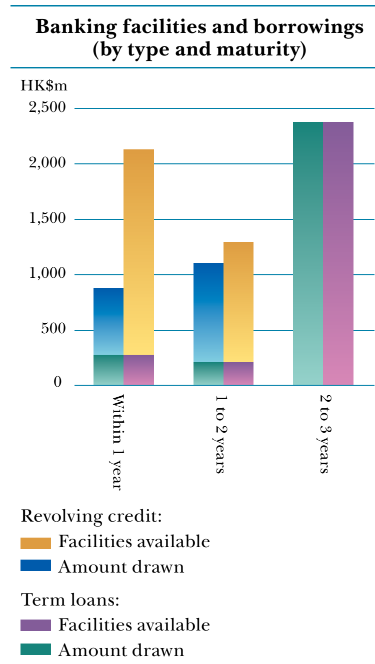
** Represented HSH's attributable share of borrowings.*

Derivative financial instruments
Derivative financial instruments are generally used to hedge interest rate and exchange rate risks of the Group and are recorded at their fair values.

Banking facilities and borrowings (by currency)

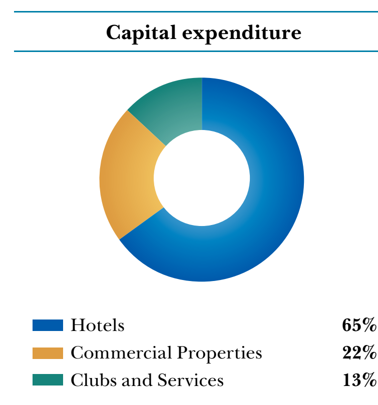


Banking facilities and borrowings (by type and maturity)



Statement of cash flows

Net cash generated from operating activities increased to HK$1,019 million as compared to HK$761 million in 2009. The increase was mainly due to the increase in revenue, mainly from the Hotels Division as explained above. A majority of the operating cash flows was applied to capital expenditure and the payment of interest and dividends.



Capital expenditure incurred by the Group during 2010 amounted to HK$276 million (2009: HK$360 million) and the breakdown of this sum is as follows:

(HK$m)	2010	2009
Hotels	**180**	159
Commercial Properties	**61**	103
Clubs and Services	**35**	7
Payment for the acquisition of additional interest in a subsidiary	**–**	91
	276	360

The net cash inflow after capital expenditure, interest and dividends for the year was HK$568 million, compared to an outflow of HK$824 million in 2009. The net cash outflow in 2009 was mainly due to the payment of HK$1,044 million for the acquisition of a 20% interest in the Peninsula Paris project.

After accounting for investing and financing activities and excluding bank deposits maturing after more than three months amounting to HK$997 million (2009: HK$437 million), cash and cash equivalents as at 31 December 2010 amounted to HK$1,644 million (2009: HK$1,380 million).

Off balance sheet information

The following transactions and events are not reflected in the Group's income statement, statement of financial position and statement of cash flows but are considered relevant to the users of the Financial Statements.

Capital commitments

The Group is committed to enhancing the asset value of its hotel and investment properties and improving the service quality of these assets. As at 31 December 2010, the Group's capital commitment amounted to HK$1,931 million (2009: HK$738 million) and the breakdown is as follows:

(HK$m)	2010	2009
Capital expenditure		
Contracted for	**60**	80
Authorised but not contracted for	**1,703**	394
	1,763	474
The Group's share of capital commitments of a jointly controlled entity		
Contracted for	**–**	40
Authorised but not contracted for	**168**	224
	168	264
	1,931	738

The Group holds a 20% equity interest in Al Maha Majestic S.à r.l., an associate of the Group responsible for the development of The Peninsula Paris project. The Group's 20% share of the contracted for and authorised but not contracted for capital commitments as at 31 December 2010 amounted to HK$108 million (2009: HK$37 million) and HK$435 million (2009: HK$474 million) respectively. It is planned that these capital commitments will be materially financed by way of bank borrowings by the associate and only in the event of the associate being unable to arrange the funding would the Group be required to meet the shortfall.

The Group's authorised but not contracted for commitments as at 31 December 2010 included a planned spending of HK$1,181 million for a major renovation of the guestrooms of The Peninsula Hong Kong ("PHK") and a significant phased upgrade programme at The Repulse Bay Complex ("TRB"). The spending profile of this capital commitment is analysed as follows:

(HK$m)	PHK	TRB	Total
During 2011	93	175	268
During 2012	266	318	584
During 2013	83	218	301
After 2013	8	20	28
	450	731	1,181

Contingent liabilities

Contingent liabilities as at 31 December 2010 for the Group and the Company are analysed as follows:

	Group		Company	
(HK$m)	**2010**	2009	**2010**	2009
Guarantees given in respect of borrowings and other banking facilities for subsidiaries	**–**	–	**4,402**	3,866
Other guarantees	**1**	1	**1**	1
	1	1	**4,403**	3,867

The Directors consider that the above contingent liabilities are unlikely to materialise. Therefore, no provision was made in the Financial Statements.

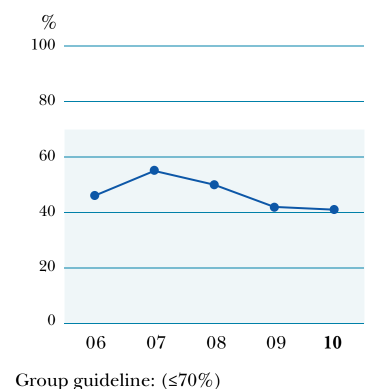
Non-adjusting post reporting period event

After the end of the reporting period, the Directors proposed a final dividend of 8 HK cents per share in respect of the year ended 31 December 2010, which will be payable on 24 June 2011. The final dividend is subject to the approval by shareholders at the forthcoming Annual General Meeting to be held on 16 May 2011 and no provision was made in the Financial Statements.

Treasury Management

All of 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.

Top 3 banks' aggregated committed facility exposure



Group guideline: (≤70%)

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.

Liquidity risk
The Group's policy is to regularly monitor current and expected liquidity requirements and compliance with loan covenants to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments. In May 2010, Peninsula of Tokyo Limited, a wholly-owned subsidiary, signed two five-year term loan facilities of JPY6 billion each with two international banks. These facilities are unsecured and guaranteed by the Company.

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 monitored to ensure sufficient funding whenever there is any potential corporate activity with significant cash flow implication. Whilst all funding methods will be considered, bank financing is currently the Group's main source of funding.

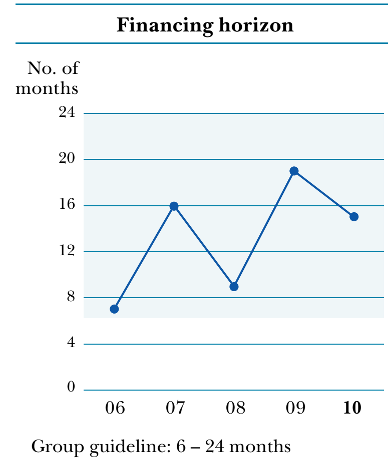
In addition, the Group seeks to maintain a balanced debt maturity profile to minimise refinancing risk.

Generally speaking, mortgage or pledge of assets is not provided to secure borrowing facilities unless significant cost savings or non-recourse financing can be obtained.

The Group monitors its gearing in accordance with the policy that its adjusted gearing ratio, expressed as the percentage of net borrowings to the total of net borrowings and net assets after taking into account the Group's share of net borrowings and net assets of non-consolidated entities (such as The Peninsula Beverly Hills and The Peninsula Shanghai), should be maintained at below 40%. As at 31 December 2010, the Group's gearing decreased to 5% (2009: 7%) and adjusted gearing (including share of net borrowings of non-consolidated entities) remained at 10% (2009: 10%).

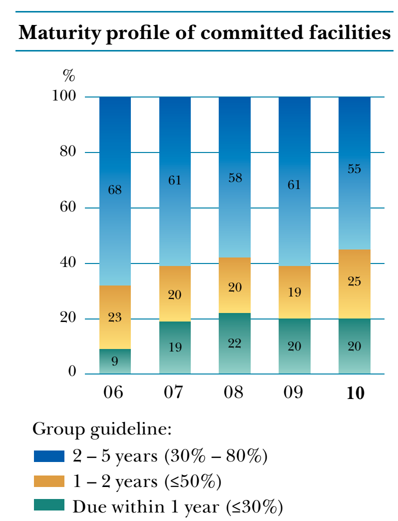
Care is taken to ensure that borrowing facilities do not impose unduly onerous or restrictive covenants and that the terms of the facilities match the underlying funding requirements. The Group's financial position is reviewed periodically to ensure compliance with loan covenants.

Financing horizon



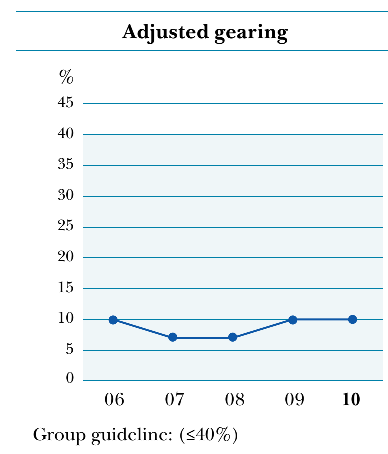
Group guideline: 6 – 24 months

Maturity profile of committed facilities



Group guideline:
2 – 5 years (30% – 80%)
1 – 2 years (≤50%)
Due within 1 year (≤30%)

Adjusted gearing



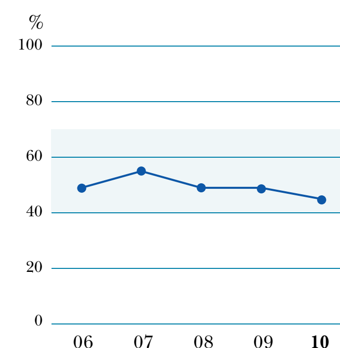
Group guideline: (≤40%)

Interest rate risk
The Group's interest rate risk management policy focuses on reducing the Group's exposure to changes in interest rates.

In addition to raising funds directly on a fixed rate basis, the Group may use interest rate swaps or cross currency 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.

As at 31 December 2010, the Group's fixed to floating interest rate ratio was at 45% (2009: 49%).

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



Group guideline: (40% – 70%)

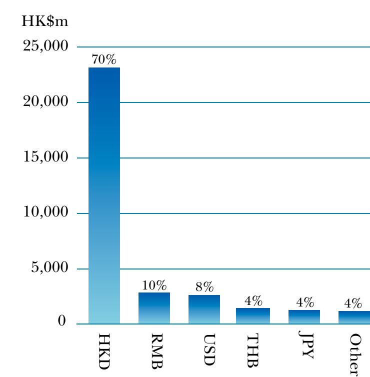
Foreign exchange risk
Significant exposure to movements in exchange rates on individual transactions is monitored and may be hedged by using spot or forward foreign exchange contracts or other derivative financial instruments where active markets for the relevant currencies exist. All significant foreign 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 Dollar 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.

As at 31 December 2010, the Group's total assets were principally denominated in Hong Kong Dollar which accounted for 70% of the total asset value.

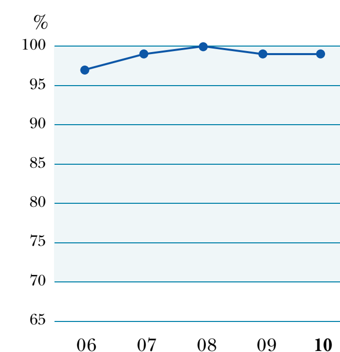
Total assets



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.

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

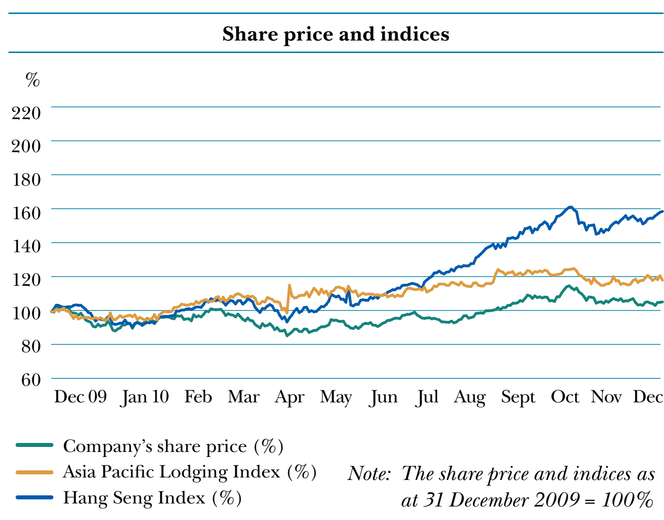


Group guideline: (≥70%)

Share Information

The Company's share price closed on 22 March 2011 at HK$14.1, giving a market capitalisation of HK$20.9 billion (US$2.7 billion). This reflects a discount of 28% to net assets attributable to shareholders of the Company, or a discount of 35% to the adjusted net assets (see page 53).

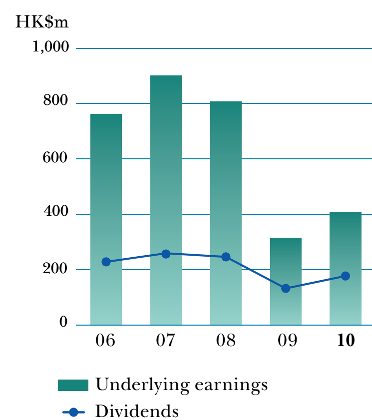
As reflected in the table on the right, the Company's share price outperformed the Hang Seng Index throughout 2010 and also outperformed the Asia Pacific Lodging Index in the first half of 2010. The average closing price during 2010 was HK$12.49, with the highest closing price of HK$14.9 achieved on 19 October 2010 and the lowest closing price of HK$10.32 recorded on 29 January 2010.



Dividends

In addition to capital appreciation (in the form of the performance of our share price over time), the Company seeks to provide its shareholders with investment return through the payment of dividends. Over the past five years, the Company's dividend payout rates have been between 30% and 45% of underlying earnings.

Given the improved operating results, the Board has recommended a final dividend payable on 24 June 2011 of 8 HK cents per share. Together with the 2010 interim dividend of 4 HK cents per share paid on 5 November 2010, the total dividend in respect of the 2010 financial year will be 12 HK cents per share.



Total Shareholder Return

Total shareholder return ("TSR") is calculated based on the capital gains and dividends of the stock. HSH had a TSR of 18.17% for 2010. During the period from 2006 to 2010, the Company provided an annualised TSR of 10.97%, versus 12.63% and 11.92% for the Hang Seng Index and the Asia Pacific Lodging Index respectively.