Financial Review

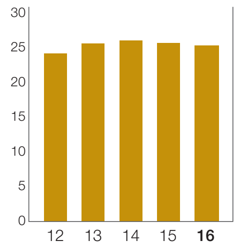
The financial details outlined in this chapter provide an overview of the Group's consolidated results and financial capital as categorised by the International Integrated Reporting Framework, which refers to the pool of funds that is available to an organisation for use in the production of goods or the provision of services.

ADJUSTED NAV

HK$39,711m flat

Adjusted NAV per share

HK$m



The Group's adjusted net assets value

In the Financial Statements, the Group's hotels (other than shopping arcades and offices within the hotels) and golf courses are stated at depreciated cost less accumulated impairment losses, if any, and not at fair value.

Accordingly, we have commissioned an independent third-party fair valuation of the Group's hotels and golf courses as at 31 December 2016, the details of which are set out on page 57. If these assets were to be stated at fair value, the Group's net assets attributable to shareholders would increase by 9% to HK$39,711 million as indicated in the table below.

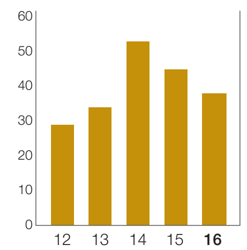
HK$m	**2016**		2015	
Net assets attributable to shareholders per the audited statement of financial position		**36,359**		36,427
Adjusting the value of hotels and golf courses to fair value	**3,815**		3,685	
Less: Related deferred tax and non-controlling interests	**(463)**		(485)	
		3,352		3,200
Adjusted net assets attributable to shareholders		**39,711**		39,627
Audited net assets per share (HK$)		**23.20**		23.61
Adjusted net assets per share (HK$)		**25.34**		25.68

UNDERLYING EARNINGS

HK$606m -12%

Underlying Earnings per share

HK cents



The Group's underlying earnings

Our operating results are mainly derived from the operation of hotels and leasing of commercial properties. We manage the Group's operations with principal reference to their underlying operating cash flows and recurring earnings. To comply with accounting standards, we are required to include non-operating and non-recurring items, such as any changes in the fair value of investment properties, in our statement of profit or loss. To reflect the true performance of the Group, we have provided calculations of the underlying profit attributable to shareholders and underlying earnings per share. These are determined by excluding the post-tax effects of the property revaluation movements and other non-operating and non-recurring items.

The Group's underlying profit attributable to shareholders for the year ended 31 December 2016 amounted to HK$606 million, a decrease of 12% compared to 2015, mainly due to the renovation at The Peninsula Beijing. The challenging retail market in Hong Kong and China also had an impact on our retail arcades.

HK$m	2016	2015	2016 vs 2015
Profit attributable to shareholders	**675**	1,000	
Adjustment for fair value movement of investment properties, including the Group's share of revaluation movement of The Peninsula Shanghai, net of tax and non-controlling interest	**(69)**	(258)	
Effect of decrease in tax rates on deferred tax liabilities arising from revaluation gains on investment properties	**–**	(54)	
Underlying profit attributable to shareholders	**606**	688	(12%)
Underlying earnings per share (HK$)	**0.39**	0.45	(13%)

Statement of profit or loss

The Group's consolidated statement of profit or loss for the year ended 31 December 2016 is set out on page 170. The following table summarises the key components of the Group's profit attributable to shareholders. This table should be read in conjunction with the commentaries set out on pages 52 to 55 of this Financial Review.

HK$m	2016	2015	2016 vs 2015
Revenue	**5,631**	5,741	(2%)
Operating costs	**(4,343)**	(4,301)	1%
EBITDA	**1,288**	1,440	(11%)
Depreciation and amortisation	**(464)**	(426)	9%
Net financing charges	**(96)**	(68)	41%
Share of result of The Peninsula Shanghai*	**20**	(71)	n/a
Share of results of The Peninsula Paris and The Peninsula Beverly Hills**	**(25)**	(23)	9%
Increase in fair value of investment properties	**29**	277	(90%)
Taxation	**(85)**	(124)	(31%)
Profit for the year	**667**	1,005	(34%)
Non-controlling interests	**8**	(5)	n/a
Profit attributable to shareholders	**675**	1,000	(33%)

* Being the Group's 50% share of The Peninsula Shanghai's (PSH) result. The 2016 figure includes the Group's share of unrealised loss of HK$19 million (2015: HK$37 million) arising from the revaluation of PSH's investment properties, net of tax

** Being the Group's 20% share of The Peninsula Paris' operating loss net of its 20% share of The Peninsula Beverly Hills' profit

REVENUE

HK$5,631m
-2%

Hotels

HK$4,040m
-1%

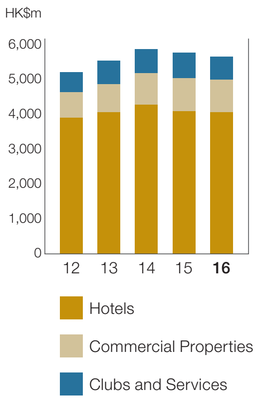
Commercial Properties

HK$935m
flat

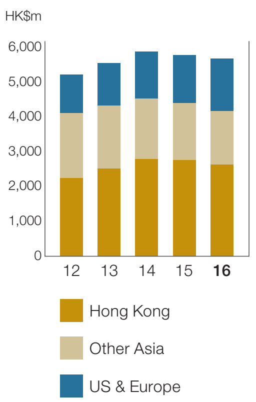
Clubs and Services

HK$656m
-10%

Consolidated Revenue by Business Segment



Consolidated Revenue by geographical segment



Revenue

The Group's revenue in 2016 decreased by 2% to HK$5,631 million. A breakdown of this by business segment and geographical segment is set out in the following tables.

Consolidated revenue by business segment

HK$m	**2016**	2015	2016 vs 2015
Hotels	**4,040**	4,073	(1%)
Commercial Properties	**935**	937	–
Clubs and Services	**656**	731	(10%)
	5,631	5,741	(2%)

Consolidated revenue by geographical segment*

HK$m	**2016**	2015	2016 vs 2015
Hong Kong	**2,615**	2,749	(5%)
Other Asia	**1,526**	1,624	(6%)
USA and Europe	**1,490**	1,368	9%
	5,631	5,741	(2%)

* The segment revenue of the Group is analysed based on the geographical location at which the properties are located and the services were provided

The hotels division is the main contributor to the Group's revenue, accounting for 72% (2015: 71%) of total revenue. The operating performance of the Group's hotel businesses is subject to a higher degree of volatility by nature. The decrease in revenue of the hotels division was predominantly due to the room closures for the renovation undertaken by The Peninsula Beijing.

The operating performance of the commercial properties division remained stable compared with last year. The decrease in revenue for the clubs and services division was mainly due to the loss of income from Peninsula Clubs & Consultancy Services following the termination of the management contracts for the Cathay Pacific Lounges at Hong Kong International Airport with effect from 1 May 2016.

Details of the operating performances of the Group's individual operations are set out on pages 24 to 44 of the CEO's Strategic Review.

Operating costs

In 2016, our operating costs (excluding depreciation and amortisation) increased by 1% to HK$4,343 million (2015: HK$4,301million).

Given the nature of operating high-end luxury hotels, staff costs continued to be the largest portion of operating costs. Staff costs and related expenses for the year increased by 2% to HK$2,108 million, representing 49% (2015: 48%) of the Group's operating costs and 37% (2015: 36%) of the Group's revenue.

EBITDA and EBITDA Margin

EBITDA (earnings before interest, taxation, depreciation and amortisation) of the Group decreased by HK$152 million or 11% to HK$1,288 million in 2016. The table below sets out the breakdown of the Group's EBITDA by business segment and by geographical segment.

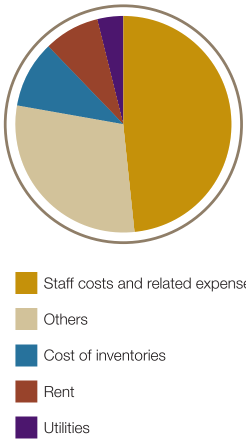
EBITDA* (HK$m)	Hong Kong	Other Asia	USA and Europe	Total
2016				
Hotels	**493**	**74**	**82**	**649**
Commercial Properties	**479**	**15**	**24**	**518**
Clubs and Services	**123**	**5**	**(7)**	**121**
	1,095	**94**	**99**	**1,288**
	85%	**7%**	**8%**	**100%**
2015				
Hotels	539	166	72	777
Commercial Properties	502	15	21	538
Clubs and Services	123	8	(6)	125
	1,164	189	87	1,440
	81%	13%	6%	100%
Change 2016 vs 2015	(6%)	(50%)	14%	(11%)

* With effect from 2016, to more accurately reflect the profitability of each segment, the inter-company fees charged by the Head Office to individual properties are included in the segment relating to that entity. The comparative figures have been restated to conform to the current year's presentation

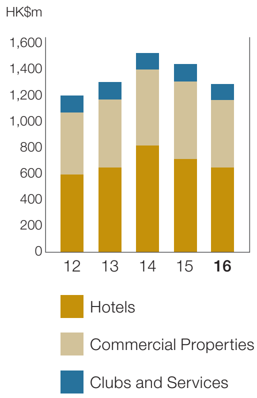
EBITDA Margin	**2016**	2015
Hotels	**16%**	19%
Commercial Properties	**55%**	57%
Clubs and Services	**18%**	17%
Overall EBITDA margin	**23%**	25%
By region:		
Hong Kong	**42%**	42%
Other Asia	**6%**	12%
USA and Europe	**7%**	6%

OPERATING COSTS

HK$4,343m
+1%



EBITDA by Business Segment



The luxury hotel business is a labour-intensive industry with high fixed costs. The decrease in EBITDA margin for the hotels division in 2016 was mainly due to the low margins earned by The Peninsula Beijing and The Peninsula Chicago during their renovations. Revenue was down significantly due to the closure of rooms, and we made a strategic decision to not lay off any staff during the renovation period – instead investing in our people and improving service levels by increasing their training and cross-exposure to other hotels. Therefore, we could not achieve a corresponding reduction in operating costs due to continuing staff costs and overhead expenses. The decrease in the EBITDA margin for the commercial properties division was mainly due to the increase in operating costs and a reduction in net rental yield from 1-5 Grosvenor Place, as the property is offering shorter-term leasing in preparation for vacant possession of the building in the second quarter of 2017. For the clubs and services division, despite the loss of income following the termination of the Cathay Pacific Lounges' management contracts, with continuous efforts to contain costs, we were able to maintain our EBITDA margin at a healthy level.

Depreciation and amortisation

The depreciation and amortisation charge of HK$464 million (2015: HK$426 million) largely relates to hotels. Depreciation charges are substantial and as such the Group adopts a rolling 5-year capital expenditure plan that is reviewed regularly to monitor planned replacement of furniture, fixtures and equipment, purchase of new items and major upgrade or enhancement projects.

Increase in fair value of investment properties

Investment properties of the Group were revalued as at 31 December 2016 by independent firms of valuers based on income capitalisation approach. The reduction in revaluation surplus was a reflection of the general market conditions. The net surplus in 2016 was principally attributable to the increase in the appraised market value of The Repulse Bay Complex, The Peninsula Office Tower, The Peak Tower, St. John's Building and 21 avenue Kléber net of the decrease in appraised market value of The Landmark, Vietnam and the commercial arcades at The Peninsula Hong Kong and The Peninsula Beijing.

Share of result of The Peninsula Shanghai

The Group, through its joint venture The Peninsula Shanghai Waitan Hotel Company Limited (PSW), owns a 50% interest in The Peninsula Shanghai Complex which comprises a hotel, a shopping arcade and a residential tower of 39 apartments, of which 19 apartment units were reclassified as apartments held for sale in 2013.

During 2016, The Peninsula Shanghai remained the market leader in terms of average room rate and RevPAR in its competitor set, generating an EBITDA of HK$273 million (2015: HK$159 million), of which HK$72 million (2015: HK$35 million) was derived from the sale of 4 apartment units (2015: 2 apartment units). In addition, The Peninsula Shanghai Complex recorded a net unrealised loss of HK$38 million on revaluation of the hotel arcade (2015: HK$74 million). After accounting for the unrealised revaluation loss, depreciation and interest, PSW generated a net profit of HK$40 million (2015: net loss of HK$142 million). The Group's share of profit thereon amounted to HK$20 million (2015: share of loss of HK$71 million).

Details of the operating performance of The Peninsula Shanghai are set out in the CEO's Strategic Review section on pages 28 and 29.

Share of results of The Peninsula Beverly Hills and The Peninsula Paris

The Group has a 20% interest in each of The Peninsula Beverly Hills and The Peninsula Paris. The Group's share of net loss of these two hotels for 2016 amounted to HK$25 million (2015: HK$23 million).

Details of the operating performances of The Peninsula Beverly Hills and The Peninsula Paris are set out in the CEO's Strategic Review section on pages 36 and 37.

Statement of financial position

The Group's financial position as at 31 December 2016 remained strong and net assets attributable to shareholders amounted to HK$36,359 million, representing a per share value of HK$23.20 compared to HK$23.61 in 2015. The consolidated statement of financial position of the Group as at 31 December 2016 is presented on page 172 and the key components of the Group's assets and liabilities are set out in the following table:

HK$m	2016	2015	2016 vs 2015
Fixed assets	**40,712**	39,097	4%
Other long-term assets	**2,223**	2,169	2%
Cash at banks and in hand	**2,087**	2,919	(29%)
Other assets	**848**	904	(6%)
	45,870	45,089	2%
Interest-bearing borrowings	**(6,998)**	(6,192)	13%
Other liabilities	**(2,298)**	(2,237)	3%
	(9,296)	(8,429)	10%
Net assets	**36,574**	36,660	–
Represented by			
Shareholders' funds	**36,359**	36,427	–
Non-controlling interests	**215**	233	(8%)
Total equity	**36,574**	36,660	–

Fixed assets

The Group has interests in ten operating hotels in Asia, US and Europe. In addition to hotel properties, we own residential apartments, office towers and commercial buildings for rental purposes.

Our hotel properties and investment properties are dealt with under different accounting policies as required by accounting standards. The 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. Therefore, independent valuers have been engaged to conduct a fair valuation of the hotel properties and golf courses as at 31 December 2016. A summary of the Group's hotel, commercial and other properties showing both the book value and the fair value as at 31 December 2016 is set out in the table on the following page.

		2016		2015	
		Value of 100% of the property (HK$m)			
	Group's interest	**Fair value valuation**	**Book value**	Fair value valuation	Book value
Hotel properties *					
The Peninsula Hong Kong	100%	**12,031**	**9,882**	12,084	9,989
The Peninsula New York	100%	**2,378**	**1,757**	2,414	1,741
The Peninsula Beijing	76.6%**	**1,716**	**1,485**	1,321	1,156
The Peninsula Tokyo	100%	**1,567**	**1,446**	1,458	1,420
The Peninsula Chicago	100%	**1,331**	**1,268**	1,340	1,221
The Peninsula Bangkok	75%	**606**	**590**	597	595
The Peninsula Manila	77.4%	**139**	**138**	163	160
		19,768	**16,566**	19,377	16,282
Commercial properties					
The Repulse Bay Complex	100%	**16,930**	**16,930**	16,862	16,862
The Peak Tower	100%	**1,362**	**1,362**	1,345	1,345
St. John's Building	100%	**1,027**	**1,027**	967	967
21 avenue Kléber	100%	**621**	**621**	509	509
1-5 Grosvenor Place	100%#	**2,583**	**2,583**	3,278	3,278
The Landmark	70%$^{\Delta}$	**68**	**68**	77	77
		22,591	**22,591**	23,038	23,038
Other properties					
Thai Country Club golf course	75%	**211**	**242**	210	237
Quail Lodge resort, golf course and vacant land	100%	**307**	**286**	305	289
Vacant land in Thailand	75%	**390**	**390**	382	382
Others	100%	**344**	**219**	335	225
		1,252	**1,137**	1,232	1,133
Total market/ book value		**43,611**	**40,294**	43,647	40,453
Hotel and investment property held by a joint venture					
The Peninsula Shanghai Complex $^{\Delta\Delta}$	50%	**4,556**	**4,256**	4,895	4,628
Hotel properties held by associates					
The Peninsula Paris	20%	**5,220**	**5,017**	5,517	5,347
The Peninsula Beverly Hills	20%	**2,640**	**479**	2,636	467

* Including the shopping arcades and offices within the hotels

** The Group owns 100% economic interest of The Peninsula Beijing with a reversionary interest to the PRC partner in 2033 upon expiry of the co-operative joint venture period

Δ The Group owns 50% economic interest of The Landmark with a reversionary interest to the Vietnamese partner in 2026 upon expiry of the joint venture period

$\Delta\Delta$ Excluding the apartment units held for sale

The Group acquired the remaining 50% interest in 1-5 Grosvenor Place in September 2016 and the property is now wholly-owned

Other long-term assets

The other long-term assets as at 31 December 2016 of HK$2,223 million (2015: HK$2,169 million) principally comprise the Group's 50% interest in The Peninsula Shanghai, the Group's 20% interest in The Peninsula Paris (PPR) and the related hotel operating right in respect of PPR and the Group's 50% interest in The Peninsula Istanbul which is under development.

Cash at banks and in hand and interest-bearing borrowings

As at 31 December 2016, the Group's cash at banks and in hand and interest-bearing borrowings amounted to HK$2,087 million (2015: HK$2,919 million) and HK$6,998 million (2015: HK$6,192 million) respectively. The increase in interest-bearing borrowings was mainly due to the acquisition of additional interest in 1-5 Grosvenor Place. A breakdown of the Group's capital expenditure for the year ended 31 December 2016 is set out on page 59.

Cash flows

The consolidated statement of cash flows of the Group for the year ended 31 December 2016 is set out on page 174. The following table summarises the key cash movements for the year ended 31 December 2016.

HK$m	**2016**	2015
EBITDA	**1,288**	1,440
Net change in working capital	**24**	4
Tax payment	**(136)**	(224)
Net cash generated from operating activities	**1,176**	1,220
Capital expenditure on existing assets		
– The Peninsula Beijing and The Peninsula Chicago	**(686)**	(195)
– Others	**(314)**	(281)
Net cash inflow after normal capital expenditure	**176**	744
Acquisition of additional interest in 1-5 Grosvenor Place	**(1,288)**	–
Acquisition of The Peninsula Tokyo's hotel building	**–**	(732)
Capital expenditure on new projects	**(131)**	(184)
Net cash outflow before dividends and other payments	**(1,243)**	(172)

The after-tax net cash generated from operating activities for the year amounted to HK$1,176 million (2015: HK$1,220 million), of which HK$1,000 million (2015: HK$476 million) was applied to fund capital expenditure on existing assets.

The breakdown of the Group's spending on its existing assets is analysed below:

HK$m	**2016**	2015
Hotels		
The Peninsula Beijing and The Peninsula Chicago	**686**	195
Others	**170**	139
Commercial properties	**105**	77
Clubs and services	**39**	65
	1,000	476

Capital and treasury management

The Group is exposed to liquidity, foreign exchange, interest rate and credit risks in the normal course of business and have policies and procedures in place to manage such risks.

The Group manages treasury activities centrally at its corporate office in Hong Kong. The Group also regularly reviews its capital structure and actively monitors current and expected liquidity requirements to ensure its obligations and commitments are met. A proactive approach is taken to forecasting future funding requirements and, when funds are needed, market conditions are evaluated to determine the best form of finance to be secured.

In addition, the Group maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to ensure funds are available to meet its financial obligations and to finance its growth and development.

Liquidity/financing

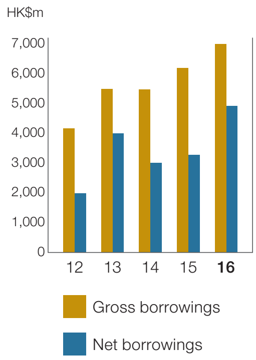
The Group monitors its capital structure on the basis of its gearing ratio, which is expressed as the percentage of net borrowings (defined as interest-bearing borrowings less cash at banks and in hand) to the total of net borrowings and equity attributable to shareholders of the Company.

In 2016, gross borrowings increased to HK$6,998 million (2015: HK$6,192 million) mainly due to the payment for the acquisition of Grosvenor's 50% interest in the London project. Consolidated net debt increased to HK$4,911 million as compared to HK$3,273 million in 2015, after taking into account cash of HK$2,087 million (2015: HK$2,919 million). The Group's net gearing increased to 12%, whilst the funds from operations (EBITDA less tax paid and less net interest paid) to net debt ratio decreased from 35% to 22%. These ratios continue to reflect a healthy financial position for the Group.

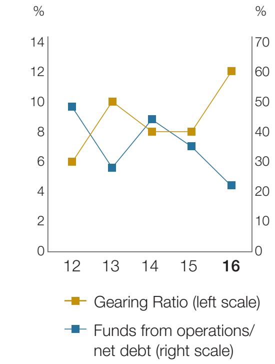
The average debt maturity decreased from 3.9 years to 3.2 years.

During the year, the Company has obtained 2 new credit facilities totalling HK$2,100 million in Hong Kong and a credit facility of THB800 million for a subsidiary to refinance its maturing loans.

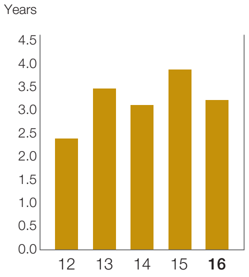
Gross and Net Borrowings



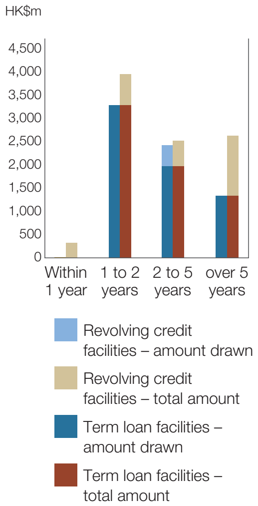
Gearing and Funds from Operations to Net Debt



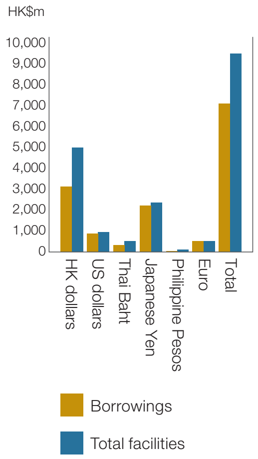
Average Debt Maturity



Banking Facilities and Borrowings (by type and maturity)



Banking Facilities and Borrowings (by currency)



In addition to the Group's consolidated borrowings, The Peninsula Shanghai (50% owned), The Peninsula Beverly Hills (20% owned) and The Peninsula Paris (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 2016 are summarised as follows:

	2016					2015
HK$m	**Hong Kong**	**Other Asia**	**United States of America**	**Europe**	**Total**	Total
Consolidated gross borrowings	**3,070**	**2,529**	**910**	**489**	**6,998**	6,192
Non-consolidated gross borrowings attributable to the Group*						
The Peninsula Shanghai (50%)	**–**	**989**	**–**	**–**	**989**	1,088
The Peninsula Beverly Hills (20%)	**–**	**–**	**214**	**–**	**214**	219
The Peninsula Paris (20%)	**–**	**–**	**–**	**357**	**357**	370
Non-consolidated borrowings	**–**	**989**	**214**	**357**	**1,560**	1,677
Consolidated and non-consolidated gross borrowings	**3,070**	**3,518**	**1,124**	**846**	**8,558**	7,869

* Represents HSH's attributable share of borrowings

Foreign exchange

The Group reports its financial results in Hong Kong dollars and does not hedge US dollar exposures in the light of the HK-US dollar peg. The Group mostly uses cross currency swaps, foreign exchange swaps or forward exchange contracts to hedge foreign exchange exposures.

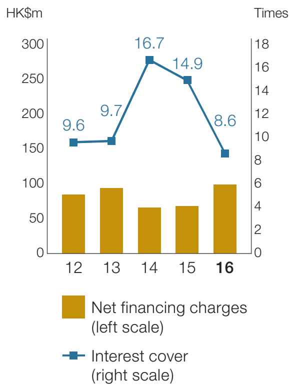
All of the Group's borrowings are denominated in the functional currency of the operations to which they relate. As at 31 December 2016, Hong Kong dollar borrowings represented 44% (2015: 37%) of total borrowings. Other balances were mainly in US dollars, Japanese yen and other local currencies of the Group's entities.

Interest rate risk

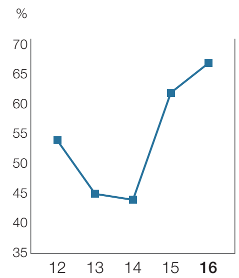
The Group has an interest rate risk management policy which focuses on reducing the Group's exposure to changes in interest rates by maintaining a prudent mix of fixed and floating rate liabilities. In addition to raising funds directly on a fixed rate basis, the Group also uses interest rate swaps or cross currency interest rate swaps in managing its long-term interest rate exposure.

Financing charges on borrowings in 2016 amounted to HK$133 million (2015: HK$124 million). After interest income of HK$37 million (2015: HK$56 million), a net charge of HK$96 million (2015: HK$68 million) was recognised in the statement of profit or loss. Interest cover (operating profit divided by net financing charges) decreased to 8.6 times (2015: 14.9 times) in 2016. As at 31 December 2016, the Group's fixed to floating interest rate ratio increased to 67% (2015: 62%) arising from fixed rate borrowings of HK$800 million arranged during the year. The weighted average gross interest rate for the year decreased from 2.2% to 2.1%.

Net Financing Charges and Interest Cover



Long Term Fixed-to-Total Borrowings (adjusted for the hedging effect)



Credit risk

The Group manages its exposure to non-performance of counterparties by transacting with those who have a credit rating of at least investment grade when depositing surplus funds. However, in developing countries, it may be necessary to deal with banks of lower credit rating.

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 grade, even in developing countries, because of the longer-term effect.

As at 31 December 2016, bank deposits of HK$2,075 million (2015: HK$2,902 million) and derivatives with notional amount of HK$1,850 million (2015: HK$1,843 million) were transacted with financial institutions with credit ratings of at least investment grade.

Share information

At market close on 20 March 2017, the Company's share price stood at HK$8.8, giving a market capitalisation of HK$13.8 billion (US$1.8 billion). This reflects a discount of 62% to net assets attributable to shareholders of the Company, or a discount of 65% to the adjusted net assets attributable to shareholders (see page 50).

The average closing price during 2016 was HK$8.14, with the highest price of HK$9.49 achieved on 23 November 2016 and the lowest price of HK$7.15 recorded on 11 February 2016.