

CEO'S STRATEGIC REVIEW



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Chief Executive Officer

Our heritage, vision and development strategy

The Hongkong and Shanghai Hotels has enjoyed a long and established history spanning more than 150 years since its establishment in 1866 and we believe our company to be the oldest hotel company in the world that has been in continuous operation. Our flagship hotel property The Peninsula Hong Kong celebrated its 90th anniversary in 2018, which we have highlighted as a key theme of this report.

Whilst we have witnessed profound political and economic changes over this long period both in our home market of Hong Kong and around the world, our company remains steadfast in our key philosophies and values which are:

- to conduct business with the highest levels of integrity;
- to build on our heritage while continuing to invest in and develop our people;
- to maintain and enhance the quality of our assets,
- to continuously improve the service we offer to our guests, and
- to contribute positively to the cities in which we operate.

These values distil into a simple vision for us, which has not changed in the 17 years that I have been CEO of this group: *to develop, own and operate a small number of the highest quality hotels which we believe are considered to be amongst the finest in the world.*

Having ownership or part-ownership of each hotel is an important part of our strategy and allows us to maintain control or joint control over the design, quality, operations and capital spending in our hotels. We are therefore not willing to undertake hotels on a management contract-only basis without ownership. By taking such a long-term view and by maintaining and enhancing the quality of our assets and operations, we seek to create significant value for our shareholders from the long-term appreciation in the capital value of our properties, as well as from the increasing operating yield as each property grows its income over time.

This is the approach which we believe has enabled us to establish and sustain a brand which is now recognised as possibly the leading luxury hotel brand in the world.



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Business overview

Our group currently owns and operates ten Peninsula hotels which are located in the key gateway cities of Hong Kong, Shanghai, Beijing, Tokyo, New York, Chicago, Los Angeles, Paris, Bangkok and Manila. Throughout the years we have maintained a significant investment programme to enhance the physical condition and quality of these properties, most recently by completing major renovations at The Peninsula Hong Kong in 2014, The Peninsula Chicago in 2016 and The Peninsula Beijing in 2017. The level of quality in our hotels is such that in February 2019 we were awarded Forbes Five-star ratings for all ten of our hotels; the only hotel group in the world to achieve such a rating across its entire hotel portfolio.

In 2018, particular highlights in the hotels division included strong operating results for The Peninsula Hong Kong and The Peninsula Tokyo as well as some recovery in Bangkok and Paris. After the recent major renovations at The Peninsula Beijing and The Peninsula Chicago, I am pleased to report improved earnings for both hotels, with The Peninsula Chicago being named as the "No. 1 Luxury Hotel in the US" by *Tripadvisor* in February 2019. The other Peninsula Hotels in Shanghai, Beverly Hills, New York and Manila all reported satisfactory results in the light of their market circumstances.

We continued to make progress in the construction of our three Peninsula hotel development projects in London, Istanbul and Yangon and we will be celebrating the topping-out ceremony of The Peninsula London in June 2019.

In the group's commercial properties division, we take a similar investment approach and seek long-term returns on our exceptionally well-located properties. We own high-end residential property such as The Repulse Bay in Hong Kong's exclusive South Side and we lease commercial space to tenants at various Peninsula hotels, the Repulse Bay Arcade and the Peak Tower. Sky Terrace 428 at the Peak Tower gives tourists the opportunity to enjoy Hong Kong's panoramic views and this has been highly successful as a source of additional revenue.

With the objective of diversifying our revenue sources and increasing brand recognition in markets where we do not operate a Peninsula hotel, we established Peninsula

Merchandising Limited which is included in our clubs and services division. This subsidiary develops and distributes Peninsula-branded merchandise including the famous Peninsula Mooncakes, as well as artisanal chocolates and high-quality tea. We operate Peninsula Boutiques in key gateway cities in Asia and the US, including boutiques at Hong Kong International Airport and several Peninsula hotels. A selection of merchandise is also available for purchase online and delivery in Hong Kong, Japan and Taiwan.

Our clubs and services division includes the Peak Tram, one of Hong Kong's most popular tourist attractions with more than six million visitors per year, which has been under our group for 130 years. In October 2018, we received approval for an additional ten-year operating right for the Peak Tram up to 2035, paving the way for us to commence a HK\$684 million upgrade project which will be entirely funded by our company and is planned to be completed in 2021.

Having a diverse portfolio within the luxury hospitality niche helps to mitigate investment risks generally associated with the hospitality industry. The more stable returns of the commercial properties division and, to a smaller extent, the clubs and services division help to offset the cyclical nature of the hotel business.

More details about the business performance of each operation and project can be read in the Operational Review on pages 39 to 70.

Financial results and financial planning

Our business model as an owner-operator is a capital intensive one, but it allows us to have control or joint control over the timing of upgrading our existing assets and making investments in new developments, to ensure the highest level of quality and consistency in our product and offer a bespoke, tailored guest experience.

We create significant long-term value for our shareholders from the long-term appreciation in capital value of our properties, as well as from the increasing operating yield as the income from our assets continue to grow over time. The best example of this is our flagship property, The Peninsula Hong Kong, which in 1928 was built for what was regarded in those days as an enormous sum of HK\$3 million and today is valued at more than HK\$12 billion.



As a result of our continuous investment into and enhancement of our property assets, the company's revalued net asset value per share has grown from HK\$10.03 per share in 2002 to HK\$26.46 per share in 2018.

We are currently investing for the future and our focus for the next few years will be on the successful delivery of our new Peninsula hotel developments in London, Istanbul and Yangon as well as the Peak Tram upgrade project. With the significant capital commitments that these projects entail, we continue to carefully monitor our company's financial position. We have a strong treasury management strategy and a proactive approach is taken to forecasting future funding requirements. We maintain sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to ensure funds are available to finance our growth and development. Our net debt to total assets ratio is currently 12%, which we believe to be comfortable taking into account the expected financial obligations of our new developments.

I am pleased that we have been able to achieve a good set of financial results for 2018. The company's combined EBITDA, including the group's effective share of EBITDA of our associates and joint ventures, increased

by 6% from the previous year to HK\$1,680 million. The company's net profit attributable to shareholders increased by 8% from the previous year to HK\$1,243 million, inclusive of the revaluation gain on the group's investment properties of HK\$523 million (2017: HK\$609 million). Our underlying earnings amounted to HK\$765 million compared to HK\$801 million in 2017, inclusive of the group's share of gain of apartment sales from our joint venture in Shanghai of HK\$25 million (2017: HK\$150 million). Excluding the company's share of realised gain on apartments, our underlying earnings increased by 14% from the previous year to HK\$740 million.

Much of the cash invested in our new projects during the year was provided by funds generated from operations which amounted to HK\$1,383 million as compared to our normal capital expenditures of HK\$426 million and new project expenditures of HK\$1,208 million. The net cash outflow of the company after taking account of all capital expenditures, interest and dividends paid amounted to HK\$393 million.

More details can be read in the Financial Review on page 72.

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Driving business

We believe the fundamentals of luxury hospitality do not change over time. In addition to the beautiful décor, large spaces and elegant design of Peninsula hotel guestrooms and the specifications and attention to detail of both our front of house and back of house facilities, we seek to provide our guests a high level of personalised service, attention to detail, graciousness, and warm hospitality. We receive significant recognition and accolades for our services from prestigious publications and organisations (see Awards, page 118).

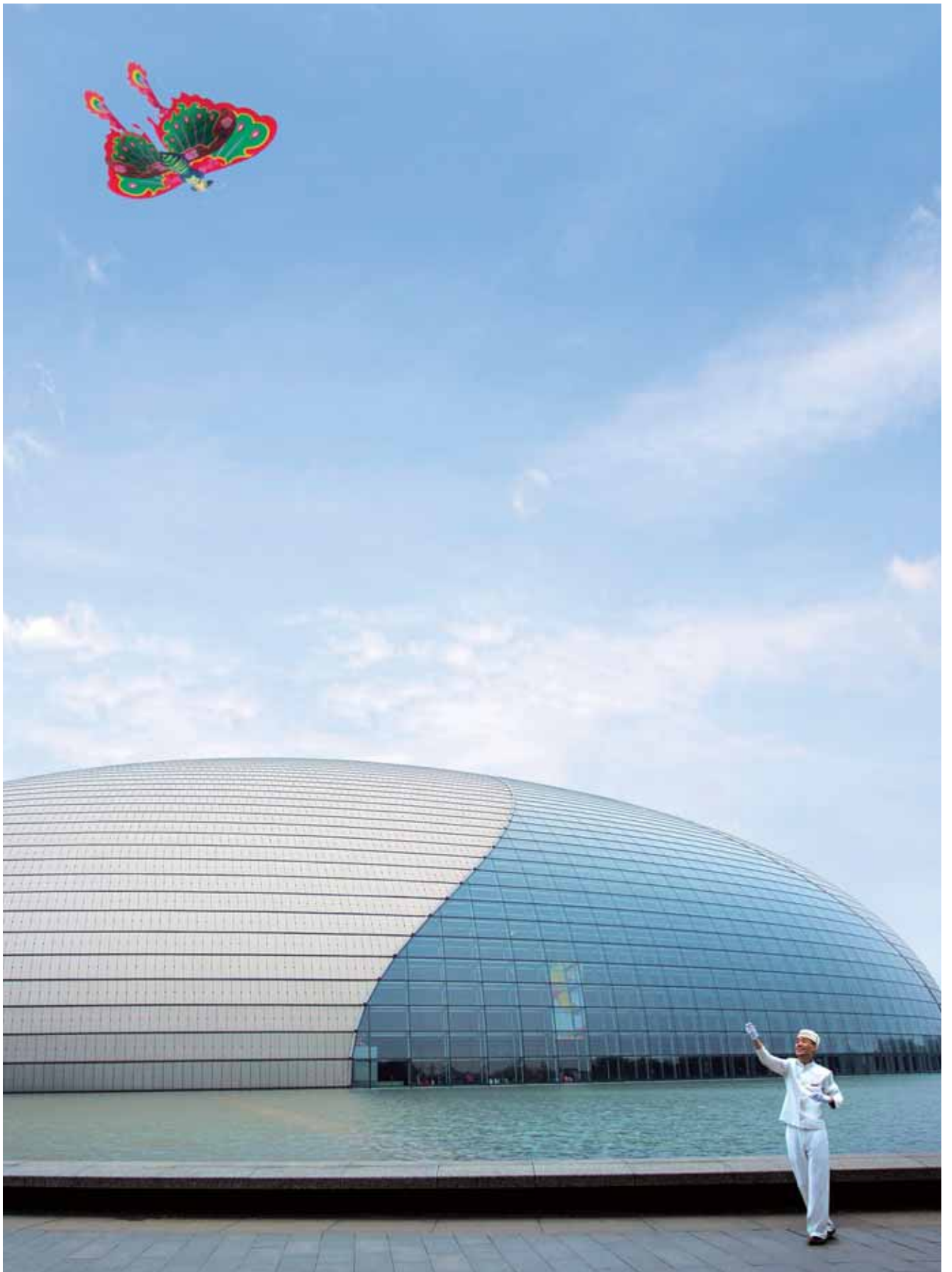
Although people always come first, we use technological developments to enhance the way in which we serve our guests. We have set up a Technology Steering Committee with a wide brief including exploring and developing the “hotel room of the future”, looking at robotics and data analytics, and fostering entrepreneurship and innovation. We operate our own in-house research and development facility which designs bespoke in-room technology for our guestrooms. Like many other hotel groups, we have developed database systems for understanding guest histories and preferences. However, it makes a difference to have staff who genuinely know the guest and will think about how to apply this information in their service. The relatively small size of our hotels means that we can personalise the attention we give to guests and guest arrivals and preferences are reviewed individually and confidentially in the hotel management morning meetings every day.

Data collection makes personalisation and customisation possible and desirable, but with ever-increasing cybersecurity threats, privacy, safety and security are more important than ever before and we must ensure our guests trust us and they are comfortable with how their data is being used. We recognise that we must be completely transparent and accountable in this regard, with General Data Protection Regulation (GDPR) compliance being a top priority.

One of the initiatives we launched in 2018 to help drive innovation was the Kaleidoscope Lab, we believe the first luxury hospitality ignition programme of its kind to be developed in collaboration with SRI International (Stanford Research Institute), under the direction of our Technology Steering Committee. We are looking forward to seeing the results and capabilities of the two innovative startups who were selected to join the first programme.

Another important part of our guest experience is to embrace the local culture, style and history of the country where the hotel is located. Nowadays a hotel stay has become much more than being somewhere to sleep and eat. Our high-end customers are looking for unique experiences to enhance their entire travel journey and we have developed Peninsula Academy Programmes for our guests to experience and enjoy. It is important to us that the stay in our hotel forms an important part of the guest's experience of visiting that particular country, with references to local architecture, artwork and culture. Appreciation of art and supporting local artists is a key part of our strategic marketing plan over the next few years, and we have designed and developed a global contemporary art programme, *Art in Resonance*, which is being launched in March 2019. More details about our commitment to art can be read on page 108.

We offer various Peninsula signatures which are designed to attract attention and a special identity for our brand. These include the Peninsula Afternoon Tea served in our lobbies, the Peninsula Pages, the Peninsula door lions, and the provision of a variety of transport options including helicopter landing facilities on the roofs of several of our hotels. In 2018 we launched a new Peninsula Yacht at The Peninsula Hong Kong which is available for guests to hire, to add to the Peninsula Yacht operating in Shanghai.



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We are focused on generating business from the Chinese mainland and we host quarterly Greater China regional meetings with senior executives who review the group's Chinese business and brand loyalty for the Greater China operations. We launched online payment capabilities at The Peninsula Shanghai and The Peninsula Beijing, with The Peninsula Hong Kong soon to follow. We are consolidating our Greater China sales and marketing activities, expanding our PenClub Chinese partners (our in-house preferred travel partner programme), and placing an increased focus on driving our retail arcades business in China.

Globally, we are enhancing our food and beverage experience to allow Peninsula guests to discover new cuisines, new beverages and new stories. The group's

signature restaurants offer sophistication, quality, and elegance, but we are also evolving to ensure our restaurants are accessible and a place where people want to come back for special experiences time and again. The group is currently defining a future strategy for its signature restaurants to define the "guest experience" as a prerequisite to development. In 2018 we launched *Z Bar* at The Peninsula Chicago, an innovative new rooftop bar with a contemporary interior and city skyline views, which has achieved an influential social media following.

In 2018 we invested in our digital marketing efforts, upgrading and enhancing the peninsula.com website with 360-video capabilities and additional functionality for visitors, as well as integration of user generated content from social media.

Managing risk

The nature of our business means that we are subject to risks and uncertainties in the execution of our business strategy. During the past year we saw the conditions surrounding a number of these risks change, resulting in a need to revisit and fine-tune the way we manage these risks for the future.

Our Group Risk Committee (GRC), chaired by the CFO, reviews the risk registers of our operations and new development projects, as well as monitors the principal risks and emerging risks of the group. We regularly evaluate the risk management and controls in response to such risks and use a 5-step risk management methodology to ensure the risk assessment process and internal controls remain current.

In 2018, we introduced a more comprehensive analysis on the risks facing each operation, and we conducted a series of risk workshops to train more than 200 senior employees across the group.

There were some changes in the principal risks, including a growing likelihood of extreme weather patterns such as super typhoons in Hong Kong due to climate change and a global trend of tightening privacy laws such as GDPR has increased the challenge of compliance. The rise in cybercrimes also exposed us to higher risks of data security breaches.

Pages 154 to 161 of our GRC Report has further details on how we manage against our principal risks.



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Investing in our people

The people who deliver the services to guests represent the face of the Peninsula brand to the outside world, providing high quality personalised services to our guests, anticipating their needs or surprising them with unexpected initiatives, whilst at the same time carefully managing and maintaining our assets and operational standards.

Our unique culture seeks to keep us unified as one team and one family. To motivate and engage our team we place a significant focus on training, career development, genuine caring for our staff, empowerment and providing a proud, confident and happy working environment. The travel and tourism sector often suffers from high turnover of staff, however, we are pleased to report a relatively low voluntary staff turnover rate compared with the industry. We are proud that at the Peninsula Hong Kong, more than one-third of our employees have over 10 years of service and in several cases, three generations of the same family have worked at the same time in the hotel.

Prior to the openings of new Peninsula hotels, we select and appoint a team of local "Peninsula ambassadors" to undergo an extensive training program in other Peninsula hotels before returning to the new hotel to be part of the opening team. They are then able to act as leaders and spread and instill Peninsula culture and practices in their colleagues working around them.

We work hard to engage and attract high potential people to work with us, and we target world-class hotel schools in our recruitment efforts. Our Corporate Management Trainee programme attracts hundreds of applicants and after a stringent hiring process, we select the best talent to participate in the programme to become our future leaders. We are committed to employing a diverse workforce and we hire people from ethnic minorities in Hong Kong through our Ethnic Minority programme (more details are available in our Corporate Responsibility and Sustainability Report online).

During 2018 we embarked on a new global employer branding campaign to assist with our recruitment efforts for the three new projects as well as each operation, targeted to their own hiring needs. We have also developed an employee experience survey and a new "onboarding" and "offboarding" process to allow us to gain insights on how we can continue to enhance our employees' working experience. At the corporate level we are implementing a change management programme aimed at modernising our workplace, titled WorkPlace 2025, to improve internal communications, embrace our unique culture and allow us to become more nimble and agile.

As of 31 December 2018, there were 7,594 full time employees in the group.





A vision for sustainable luxury

We are deeply committed to sustainability in an environmental as well as a business context – we believe that our success is inextricably linked to the success of the cities and the communities in which we live and work. Through a variety of platforms, training workshops and initiatives, we aspire to create awareness and buy-in towards sustainability throughout our company so that it becomes a living and breathing topic that matters personally to our employees and is integral to how we conduct all our businesses and operations. We also approach sustainability in a way that makes business sense where possible. We calculate paybacks and returns on investments made into environmental initiatives, and we look at what value drivers our sustainability initiatives could contribute.

We have the opportunity to offer our guests sustainable choices without compromising on the high quality of our products and services. In 2018, we took the significant step of announcing a global ban on plastic straws in our operations. This is the first phase of our plan to eliminate single-use plastics by 2020 which we believe is necessary to address the significant issue of plastics pollution. We strive to source only sustainable seafood and we have

created a *Naturally Peninsula* range of dishes focusing on healthy, nutritious cuisine from locally harvested sources. We are also focusing on ways to reduce food waste. We strive to use only Forest Stewardship Council (FSC)-certified paper for all our products and packaging.

We reported a good outcome of our energy and water efficiency efforts and we continued to see progress in achieving over 85% of the commitments in our Sustainable Luxury Vision 2020 strategy, although we have encountered challenges which are outlined in the CRS Report. Since the implementation of our Sustainable Luxury Vision 2020 strategy, we have become more aware of the systemic and multi-dimensional nature of sustainability issues. We reassessed our approach to sustainable luxury, recognising that addressing these challenges requires concerted efforts and collaborative solutions with other stakeholders. We decided to focus our efforts in three key areas of “Our Guests, Our People, and Our Cities” to echo our overall business and investment strategy.

More details can be read in the CRS Report which is available online and in the Group Corporate Responsibility Committee (GCRC) report on page 162.

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Outlook

In terms of outlook for the coming year, although we are facing uncertainties around the world and geopolitical instability in some of the regions we operate in, our current business trends are generally stable and we are cautiously optimistic. As mentioned, we are implementing a number of new strategies to drive business in the year ahead, including promoting our Chinese mainland business, enhancing our food and beverage strategy and improving data analytics.

We are confident in the continued growth of Hong Kong's tourism sector and we believe the opening of the Hong Kong section of the Express Rail Link and the Hong Kong-Zhuhai-Macau Bridge will positively impact overnight tourism arrivals.

We are optimistic for Japan as the country prepares to welcome the Rugby World Cup in 2019 and the Tokyo Olympics in 2020, and we are already seeing advance bookings for these events. We believe there is a relatively stable outlook for luxury hospitality in the US and the Chinese mainland. We are committed to maximising the growth potential of The Peninsula Beijing following its major renovation. We continue to monitor the impact of the gilets jaunes or "yellow vests" in France which has been negatively affecting our hotel in Paris. We expect that the new hotels in London, Istanbul and Yangon will further enhance our brand presence when they open from 2021 onwards.

We have been encouraged by a number of new lettings and renewals at our arcades at The Peninsula in Hong Kong, Shanghai and Beijing. We are experiencing

good demand for our luxury residential lettings in Hong Kong. Our Peak Tram business will be negatively impacted in 2019 as it will undergo several months of suspension during the first phase of its improvement and upgrade programme that was previously announced to shareholders. We expect this to affect our results in 2019 and 2020, however, in the long term we believe it will significantly improve the visitor experience and enhance Hong Kong's tourism image.

Overall, our company remains in a strong financial position with a highly motivated and dedicated team of management and staff who are committed to our long-term vision. We strongly believe that a top hospitality company is built on attention to detail, quality and an exceptional back-of-house. This passion for perfection is set by our leadership and translates through to the work of our general managers, our designers, project teams, operations teams and our partners, to create a truly prestigious brand that is celebrated across the world, and a company that consistently lives up to its unique brand proposition. I would like to thank each member of my team who contributes to our company's success year after year.



Clement Kwok

14 March 2019