
CEO'S STRATEGIC REVIEW



Clement K.M. Kwok
Chief Executive Officer

1. Introduction

2019 was a very difficult year in our home city of Hong Kong due to the serious social unrest and mass protests on the streets. No matter what one's political beliefs are, the violence and destruction was heartbreaking to witness and it is fair to say that a wide divide has emerged amongst Hong Kong's usually peace-loving, family-oriented society.

On the business front, the situation had a very negative effect on our group. As the bulk of our group's earnings are derived from Hong Kong, we had to urgently implement a widespread range of cost savings and financial management measures. On the operations side, we rapidly adopted crisis monitoring and handling procedures, with our number one priority being the safety of our guests and staff. At the time of writing in early 2020 we are currently facing a very concerning situation with the outbreak of the COVID-19 coronavirus which has spread around the world. Amidst the downturn in business brought about by these crises, we are striving to preserve jobs as a key priority. I would like to express my appreciation for all my colleagues around the world for their loyalty and their hard work at such a difficult time.

Even in difficult times like the present, we remain focused on the long term. Our financial and resources commitment to our development programme, comprising the new Peninsula projects in London, Istanbul and Yangon and the Peak Tram upgrade project, remains unaffected. I am positive that with our Peninsula team spirit we can survive and come through better and stronger than before. It is this spirit, and our culture, that lies at the heart of our business strategy and I will summarise this strategy for our shareholders' reference in the following pages.

2. Our heritage, vision and development strategy

The Hongkong and Shanghai Hotels, Limited has an exceptional heritage. Whilst we have witnessed profound political and economic changes since we

were first established in 1866, 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
- to contribute positively to the cities in which we operate

These values distill into a simple vision: *to develop, own and operate a small number of the highest quality hotels and luxury properties 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 an appropriate degree of 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. 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.



CEO's Strategic Review

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.

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



3. 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. We are in the midst of an ambitious expansion programme, with investment in three new Peninsula hotel development projects in London, Istanbul and Yangon.

Our strategy is to operate only one Peninsula hotel in each city and we have the ability to take a long-term view on real estate capital appreciation. Our hotels are considered “trophy assets” in these cities and will continue to create value over time, while generating additional returns from shopping arcades or residential apartments as part of the hotel complex. We enter into long-term partnerships with our co-owners who value the benefits of creating a high quality long-term asset. Our objective is to build up a long-term loyal clientele who are willing to pay premium prices for a superior luxury product and services. We achieve this by offering a high level of personalised service and attention to detail.

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 including 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 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 China, 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, Taiwan, Shenzhen and Guangzhou.

Our clubs and services division includes the Peak Tram, one of Hong Kong's most popular tourist attractions, which has been under our group for 130 years. The Peak Tram is currently undergoing a HK\$684 million upgrade project which is entirely funded by our company and will be completed in 2021.

Having a diverse portfolio helps to diversify investment risks generally associated with the luxury 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 37 to 66.



4. Financial results and financial planning

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

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\$26.20 per share in 2019.

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 substantial capital commitments that these projects entail, amounting to some HK\$7 billion over the next two years, 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 external debt to total assets ratio is currently 13%, which we believe to be comfortable taking into account the expected financial obligations of our new developments.

Due to the adverse situation in Hong Kong, we are reporting an unfavourable set of financial results for 2019. The company's combined EBITDA, including the group's effective share of EBITDA of our associates and joint ventures, decreased by 17% from the previous year to HK\$1,510 million. The company's net profit attributable to shareholders decreased by 59% from the previous year to HK\$494 million, inclusive of the revaluation gain on the group's investment properties of HK\$83 million (2018: HK\$523 million). Our underlying earnings amounted to \$480 million compared to HK\$738 million in 2018.

Much of the cash invested in our new projects during the year was provided by funds generated from operations which amounted to HK\$1,366 million as compared to our normal capital expenditures of HK\$395 million and the Peak Tram upgrade and new project expenditures of HK\$1,499 million. The net cash outflow of the company after taking account of all capital expenditures, interest and dividends paid amounted to HK\$794 million.

More details can be read in the Financial Review on page 68.

CEO's Strategic Review

5. Driving business

We believe the fundamentals of luxury hospitality do not change over time. Our strategy is to attract and engage our guests and we aim to generate a high percentage of repeat business. We offer a high level of personalised service, attention to detail and warm hospitality. In 2019, this was demonstrated by our achievement of receiving the highly coveted Forbes 5-star rating for all ten of The Peninsula Hotels in operation, becoming the first and only hotel company in the world to obtain this accolade for all its hotels. We receive significant recognition and accolades for our services from other prestigious publications and organisations (see Awards, page 104).

In addition to the personal touch, we recognise that guests require access to the most up-to-date technology and platforms to make their experience and journey with us as seamless as possible.

The relatively small size of our hotels means that we can personalise the attention we give to guests and cater to each guest arrival and their individual preferences. However, we understand that we must continually improve and in 2019 we undertook a major review of our Peninsula service standards. We have engaged external consultants and conducted guest surveys to better understand their expectations and how we can stay at the forefront of luxury hospitality. We have streamlined our stringent behavioural standards into nine core principles with the objective of empowering our staff to go above and beyond to engage with guests. This programme will be rolled out in 2020.

During the year we have invested in refreshed marketing collateral, content and partnerships to present the brand in a more meaningful, relevant and engaging way, while building on our rich history and heritage.



We operate our own in-house research and development facility which designs bespoke in-room technology for our guestrooms. In 2016 we 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. Projects under development in 2019 and 2020 include back-of-house automation, food waste management solutions, air purification systems and behavioural analysis for enhanced personalisation, as well as data analytics and digital marketing capabilities.

Our startup programme, Kaleidoscope Lab, was developed in collaboration with Stanford Research Institute, under the direction of our Technology Steering Committee, and this provides an additional avenue to explore ways to integrate innovative technology into our business.

Appreciation of art and supporting local artists is a key part of our strategic marketing plan. The Peninsula provides guests and visitors the opportunity to engage with immersive, experiential art, creating memories that will last for a lifetime. In March 2019, a multi-year global contemporary art programme, *Art in Resonance* was launched during Art Basel Hong Kong. We are committed to promoting the rich and vibrant cultural aspects of our destination cities – such as hosting local artists as part of our ‘Artist in Residence’ programme which is designed to support emerging artists while also providing guests access to culturally-representative pieces.

In June we partnered with world-leading independent arts charity BAFTA (The British Academy of Film and Television Arts) in Shanghai for the launch of their new programme ‘BAFTA Breakthrough China’. This was an initiative designed to identify and nurture the next generation of creative talent in Asia.

On the sales side we continued to focus on strengthening our relationships with PenClub members, our in-house preferred travel partner programme. Increasing guest direct business is a key goal for the sales and marketing team and we are placing a particular emphasis on driving business from the Chinese mainland. We will focus on adding value to our Greater China Shopping Arcade business and will adopt WeChat as a preferred communication platform. During the year we hosted quarterly Greater China regional meetings with senior executives who review the group’s Chinese mainland business and brand loyalty for the Greater China operations.

6. Managing risk

Operating a business across multiple jurisdictions, given the unpredictable nature of the hotel industry, requires an agile yet measured approach to risk management. Our Group Risk Committee (GRC), chaired by the CFO, regularly 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 evaluate key risks and controls and have adopted a 5-step risk management methodology to ensure the risk assessment process and internal controls remain current.

In 2019 there were some changes in the identified principal risks, including increased risk of our business portfolio concentration and increased reputational and financial risk due to the volatile nature of the social unrest in Hong Kong. The global trend of tightening privacy laws such as the EU’s GDPR and the California Consumer Privacy Act has increased the challenge of compliance. The increasing rise in cybercrimes has also exposed us to higher risks of data security breaches. Pages 140 to 147 of our GRC Report has further details on how we manage against our principal risks.



CEO's Strategic Review



7. Investing in our people

Building a team of exceptional people is the key to executing our strategies. The culture of our company has cultivated a loyal and committed team spirit which has resulted in a stable and cohesive management team. This team spirit starts at the top of the organisation with our majority owners the Kadoorie family and we adhere to a core set of values and integrity that permeates through all levels of the company. We believe it is important to safeguard this culture as we add significant numbers of new people to our group, with three new hotel properties coming on board. In addition to attracting and retaining talented individuals, our key objective is to develop our existing talent and to harness their potential, allowing us to become more agile and nimble as a group.



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 experiences a high turnover of staff, however, we are pleased to report a relatively low voluntary staff turnover rate compared with the industry.

We conducted an employee engagement survey during the year and the results were encouraging, with responses in every category ranking well above the global average. We had a very high voluntary response rate of 89%, while 91% of our employees stated they felt proud to work for the company, and 85% were

“extremely satisfied” with the company as a good place to work (both results were 11% higher than the global average).

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 CRS report online).

During 2019 we continued to develop 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.

As of 31 December 2019, there were 7,451 full time employees in the group.



8. A vision for sustainable luxury

We are committed to sustainability in an environmental as well as a business context. We believe that our long-term success is linked to the success of the cities and the communities in which we live and work. We have created awareness and buy-in towards sustainability throughout our company, and we hope that it becomes a 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 in environmental initiatives, and we look at what overall value 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. Our sustainability strategy, originally developed

as Sustainable Luxury Vision 2020 (Vision 2020), has been revamped our approach to focus on the three key stakeholders central to the success of our business: *Our Guests, Our People and Our Cities*.

In 2019, over 89% of the goals set in Vision 2020 were on track to be achieved. Looking beyond 2020, we are developing our next sustainability strategy with a focus on further business integration and we are taking a regenerative and proactive approach. Our new strategy will leverage the strengths of our business, focusing on issues requiring significant and urgent attention, scaling positive benefits from our business, while effectively reducing our environmental impact.

More details can be read in the Corporate Responsibility and Sustainability Report which is available online and in the GCRC report on page 148.

CEO's Strategic Review



9. Outlook

Since its outbreak in January 2020, the COVID-19 novel coronavirus has led to global travel advisories and unprecedented airline cancellations. This has led to a significant decline in tourist arrivals to Hong Kong and the Chinese mainland and has impacted other Asian markets, the US, and Europe.

Many large-scale events have been cancelled in the region and this is having a substantial negative impact on our business. We are implementing emergency measures to keep our staff and guests safe as a priority, and financial management and stringent cost controls are being implemented for the year ahead. We have reviewed our group's liquidity position and we can confirm that we have a significant buffer in place even if the impact of the virus continues for some time. However, despite these cost control efforts, we estimate that the group will sustain an operating loss in the first quarter of 2020 due to the continuing global spread of the coronavirus and the devastating impact on tourism.

We are hopeful that the spread of the coronavirus will be brought under control in the next few months and that the impact of this on the travel trade will recede. However, we continue to be concerned about the political situation in Hong Kong and the possibility that the social unrest may continue and escalate again in 2020. Besides the Hong Kong political situation, various other global uncertainties may continue to affect our business, such as the impact of Brexit, the political situation in France and uncertainties in Turkey and Syria.

In these challenging times, our priority is to maintain a strong financial position for the group in order to fund our large capital commitments for The Peninsula London, The Peninsula Istanbul and The Peninsula Yangon new hotel projects, as well as the Peak Tram expansion. Our commitment to the long-term development of the group and in particular the Peninsula brand remains unchanged. We take a very long-term view of the investments that we make and we expect the new hotels in London, Istanbul and Yangon to enhance our brand presence when they open from 2021 onwards, and to create value for stakeholders over time.

On the property side, we were encouraged by a pleasing number of rental renewals at our arcades at The Peninsula in Hong Kong, Shanghai and Beijing in 2019, although the short-to-medium term impact of the coronavirus may have a negative effect on our tenants and we are working with them to find solutions. We are currently experiencing stable demand for our luxury residential lettings in Hong Kong. The Peak Tram business will continue to be negatively impacted in 2020 during its improvement and upgrade programme that was previously announced to shareholders. 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 stable financial position. We are proactive in managing the group's liquidity. In the first three months of 2020, we have further obtained committed facilities to ensure the group's capital commitments are fully funded and have sufficient liquidity to support us through this period of business downturn.

We have a highly motivated and dedicated team of management and loyal staff who are committed to our long-term vision. I am proud that our company 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
17 March 2020



