

DIRECTORS' REPORT

The directors have pleasure in submitting their report together with the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

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

PERFORMANCE

A discussion and analysis of the group's performance during the year, the material factors underlying its results and financial position, and details of the group's principal activities are provided in the financial review on pages 52 to 67.

TEN YEAR OPERATING AND FINANCIAL SUMMARIES

Summaries of the group's operating and financial data for the last ten years are set out on pages 8 and 68.

SHARE CAPITAL

During the year, the company issued and allotted 5,500,131 new shares at HK\$5.855 per share to certain shareholders of Manila Peninsula Hotel, Inc. who have accepted the offer referred to in the announcement dated 25 February 2005. In addition, on 31 May 2005 and 29 September 2005, pursuant to scrip dividend schemes, the company issued and allotted 7,522,889 shares and 2,331,255 shares respectively at an issue price of HK\$7.62 and HK\$9.21 each to the shareholders who elected to receive shares of the company in lieu of cash for the 2004 final and 2005 interim dividends in respect of the year ended 31 December 2004 and the six months ended 30 June 2005, respectively.

All ordinary shares issued rank pari passu in all respects with the existing issued shares. Save as described above, there were no other changes in the share capital of the company. Particulars of the share capital of the company during the year are set out in note 27 to the financial statements.

DIVIDENDS

An interim dividend of 4 cents per share was paid during the year 2005. The directors have recommended a final dividend of 10 cents per share. Subject to the approval by shareholders at the forthcoming annual general meeting, such dividend will be payable on or about 23 June 2006 to shareholders whose names appear on the register of members on 18 May 2006, with a scrip dividend alternative. The register of members will be closed from 15 May 2006 to 18 May 2006, both days inclusive.

PRINCIPAL SUBSIDIARIES

Particulars of the principal subsidiaries of the company are set out on page 154.

FIXED ASSETS

Movements in fixed assets during the year are set out in note 15 to the financial statements.

CAPITALISED INTEREST

Interest amounting to HK\$8 million was capitalised by the group during the year as set out in note 5A to the financial statements.

RESERVES

Reserves available for distribution to shareholders and movements in the reserves of the company and the group during the year are set out in note 28 to the financial statements.

PURCHASE, SALE AND REDEMPTION OF LISTED SECURITIES

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

BORROWINGS

Particulars of all borrowings are set out in note 26 to the financial statements.

CHARITABLE DONATIONS

Donations made by the group for charitable purposes during the year amounted to HK\$2.6 million.

MAJOR CUSTOMERS AND SUPPLIERS

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

CONNECTED TRANSACTIONS

(a) Connected transaction

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

Kadoorie Estates acts as an agent for the registered owner, Cobalt Holding Corporation (now known as New Cobalt Holding Corporation) ("Cobalt"), which is the trustee of a unit trust, the units of which are held ultimately by discretionary trusts. The members of the Kadoorie family are discretionary objects of those discretionary trusts. At 16 March 2006 Bermuda Trust Company Limited ("Bermuda Trust") indirectly held a 54.79% interest in the issued share capital of the company and Cobalt is an indirect wholly owned subsidiary of Bermuda Trust.

(b) Continuing connected transaction

The Peninsula Manila is owned by Manila Peninsula Hotel, Inc. (MPHI – a 40% associate of the group prior to 3 March 2005). MPHI became a subsidiary on 3 March 2005 following the completion of an offer made to the shareholders as announced on 29 October 2004. The Peninsula Manila is situated on a piece of land owned by Ayala Hotels, Inc. (“Ayala”), an associate of an MPHI director. Ayala is entitled to receive contingent rental from MPHI based on 5% of the gross income of MPHI pursuant to a land lease contract dated 2 January 1975 with an initial term from 31 December 1975 to 31 December 2001 and as extended to 31 December 2027. The lease became a continuing connected transaction as defined under the Listing Rules following the completion of the offer. An announcement of the continuing connected transaction was made on 8 July 2005. The amount of rent paid to Ayala under the lease from March to December 2005 was HK\$7.4 million.

The Directors, including all the independent non-executive directors, have reviewed the above continuing connected transaction and confirmed that the transaction:

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

The company’s auditors have also reviewed the continuing connected transaction described above and confirmed to the board of directors of the company that based on their work performed, the transaction:

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

MATERIAL RELATED PARTY TRANSACTIONS

Details of material related party transactions which were undertaken in the normal course of business are set out in note 36 to the financial statements.

DIRECTORS

Biographical details of the directors in office at the date of this report are shown on pages 42 and 43. All the directors held office for the whole of 2005.

In accordance with the articles of association of the company, Sir Sidney Gordon, Mr Ronald J McAulay, Dr The Hon. Sir David K P Li and Mr C Mark Broadley will retire by rotation. Save for Sir Sidney Gordon who has indicated that he would not seek re-election at the forthcoming annual general meeting, all the other retiring directors being eligible, have agreed to offer themselves for re-election. In addition, Mr James S Dickson Leach will retire voluntarily at the forthcoming annual general meeting.

Messrs Nicholas T J Colfer and John A H Leigh will be proposed for election as non-executive directors of the company at the forthcoming annual general meeting to fill the vacancies following the retirement of Sir Sidney Gordon and Mr James S Dickson Leach.

None of the directors to be proposed for re-election or election at the forthcoming annual general meeting will have a service contract with the company or any of its subsidiaries which is not determinable by the company within one year without payment of compensation, other than statutory compensation.

ALTERNATE DIRECTORS

The Hon. Sir Michael Kadoorie, Mr William E Mocatta and Mr Ronald J McAulay have appointed Mr James S Dickson Leach as their alternate. Mr James S Dickson Leach and Sir Sidney Gordon have appointed Mr William E Mocatta and The Hon. Sir Michael Kadoorie respectively as their alternates.

Mr James S Dickson Leach will cease to be an alternate director following his retirement at the annual general meeting.

SENIOR MANAGEMENT

Biographical details of the senior management at the date of this report are shown on page 44. They held office for the whole of 2005.

INTERESTS OF DIRECTORS AND CHIEF EXECUTIVE

As at 31 December 2005, the interests and short positions of each director and the chief executive of the company in the shares, underlying shares and debentures of the company or any associated corporations, within the meaning of Part XV of the Securities and Futures Ordinance (SFO), recorded in the register required to be kept under section 352 of the SFO, or required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the company and the Stock Exchange were as follows:

Long position in shares of the company and its associated corporations

	Capacity	Number of shares held in the company	% of the issued share capital of the company
The Hon. Sir Michael Kadoorie	Note (a)	706,562,423	49.842
Mr Ian D Boyce	Beneficial Owner	203,240	0.014
Mr Clement K M Kwok	Beneficial Owner	609,724	0.043
Sir Sidney Gordon	Note (b)	70,175,083	4.950
Mr Ronald J McAulay	Note (c)	490,546,269	34.604
Mr William E Mocatta	Note (d)	1,017,000	0.072
Dr The Hon. Sir David K P Li	Beneficial Owner	508,101	0.036
Mr Robert C S Ng	Family	120,573	0.009
Mr Pierre R Boppe	Beneficial Owner	150,000	0.011
Mr C Mark Broadley	Beneficial Owner	203,240	0.014
Mr Peter C Borer	Beneficial Owner	65,295	0.005

Notes:

(a) *The Hon. Sir Michael Kadoorie was deemed (by virtue of the SFO) to be interested in 706,562,423 shares in the company. These shares were held in the following capacity:*

(i) *420,468,740 shares were held by discretionary trusts, of which The Hon. Sir Michael Kadoorie is one of the discretionary objects.*

(ii) *286,093,683 shares were held by a discretionary trust, of which The Hon. Sir Michael Kadoorie is one of the discretionary objects and the founder.*

For the purpose of the SFO, the spouse of The Hon. Sir Michael Kadoorie was taken to have a duty of disclosure in Hong Kong in relation to the 286,093,683 shares referred to in (a)(ii). The interest disclosed by the spouse of The Hon. Sir Michael Kadoorie is that of The Hon. Sir Michael Kadoorie which is attributed to her pursuant to the SFO for disclosure purposes. Nevertheless, she has no interest, legal or beneficial, in those shares.

(b) *Sir Sidney Gordon, in his capacity as trustee of a charitable trust which is one of the ultimate owners of a unit trust which holds the 70,077,529 shares referred to in Note (c)(ii), was deemed to be interested in the 70,077,529 shares. Sir Sidney Gordon holds 97,554 shares in his personal capacity.*

(c) *Mr Ronald J McAulay was deemed (by virtue of the SFO) to be interested in 490,546,269 shares in the company. These shares were held in the following capacity:*

(i) *420,468,740 shares were held by discretionary trusts, of which Mr Ronald J McAulay is one of the discretionary objects.*

(ii) *70,077,529 shares were held by a discretionary trust, of which Mr Ronald J McAulay, his wife and members of his family are discretionary objects.*

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

Messrs James S Dickson Leach, Robert W Miller and Patrick B Paul, who are directors of the company, have each confirmed that they had no interests in the shares of the company as at 31 December 2005.

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

Except as set out above, as at 31 December 2005 none of the directors and chief executive of the company, or any of their spouses, or children under eighteen years of age, has any interests or short positions in the shares, underlying shares and debentures of the company or its associated corporations, within the meaning of Part XV of the SFO, recorded in the register required to be kept under section 352 of the SFO, or required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the company and the Stock Exchange.

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

INTERESTS OF SENIOR MANAGEMENT

As at 31 December 2005, the interests of the senior management (other than directors) in the shares and underlying shares of the company were as follows:

	Capacity	Number of shares held in the company	% of the issued share capital of the company
Mr J Niklaus Leuenberger	Beneficial Owner	1,500	0.0001
Mr Martyn P A Sawyer	Beneficial Owner	25,404	0.0018

INTERESTS OF SHAREHOLDERS

So far as is known to any director or chief executive of the company, as at 31 December 2005, shareholders (other than a director or the chief executive of the company) who have an interest or short position in the shares and underlying shares of the company as recorded in the register required to be kept under section 336 of the SFO, were as follows:

Long position in shares

Substantial Shareholders

	Capacity	Number of shares held in the company	% of the issued share capital of the company
Bermuda Trust Company Limited	Trustee	776,639,952	54.785(i)
Esko Limited	Interest of controlled corporation/Beneficiary of trusts	420,468,740	29.661(ii)
Hesko Limited	Interest of controlled corporation/Beneficiary of trusts	420,468,740	29.661(ii)
HWR Trustees Limited	Interest of controlled corporation	420,468,740	29.661(v)
Acorn Holdings Corporation	Beneficiary	379,356,340	26.760(i)
Lawrencium Corporation	Beneficiary	379,356,340	26.760(i)
Lakshmi Company Limited	Beneficiary	365,947,707	25.815(v)
Merlin Investments Limited	Beneficiary	365,947,707	25.815(v)
New Xenon Holding Corporation	Trustee	365,947,707	25.815(iii)
Mikado Holding Inc.	Trustee	286,093,683	20.182(iv)
Mikado Investments Limited	Interest of controlled corporation/Beneficiary of trusts	286,093,683	20.182(iv)

These interests are duplicated to the extent of 3,690,149,387 shares. The net total of 776,639,952 shares reflects duplication of various directors' interests as set out in the section "Interests of directors and chief executive" of this report.

Notes:

- (i) The 776,639,952 shares in which Bermuda Trust Company Limited was deemed to be interested as a trustee include the 420,468,740 shares in which Esko Limited and Hesko Limited were deemed to be interested, the 379,356,340 shares in which Acorn Holdings Corporation and Lawrencium Corporation were deemed to be interested and the 286,093,683 shares in which Mikado Investments Limited was deemed to be interested.
- (ii) The interests of Esko Limited and Hesko Limited are duplicated with each other's interests.
- (iii) The 420,468,740 shares in which Esko Limited and Hesko Limited were deemed to be interested as beneficiaries includes the 365,947,707 shares in which New Xenon Holding Corporation was deemed to be interested as trustee.
- (iv) The 286,093,683 shares in which Mikado Investments Limited was deemed to be interested as a beneficiary comprises the 286,093,683 shares in which Mikado Holding Inc. was deemed to be interested as trustee.
- (v) HWR Trustees Limited was deemed to be interested in the 365,947,707 shares in which New Xenon Holding Corporation was interested by virtue of having direct control over New Xenon Holding Corporation. HWR Trustees Limited was also deemed to be interested in another 54,521,033 shares through other controlled corporations. Lakshmi Company Limited and Merlin Investments Limited were deemed to be interested in the shares in which New Xenon Holding Corporation was interested.

Except as set out above, as at 31 December 2005 the company had not been notified of any shareholder (other than a director or chief executive of the company) who had an interest or short position in the shares or underlying shares of the company that were recorded in the register required to be kept under section 336 of the SFO.

DIRECTORS' INTERESTS IN CONTRACTS

No contract of significance to which the company, its subsidiaries or fellow subsidiaries was a party, and in which a director of the company had a material interest, subsisted as at 31 December 2005 or at any time during the year.

EMPLOYEE RETIREMENT BENEFITS

Details of the group's employee retirement benefits are shown in note 32 to the financial statements.

CORPORATE GOVERNANCE

The corporate governance report is set out on pages 69 to 76.

PUBLIC FLOAT

As at 16 March 2006, the latest practicable date, based on information that is publicly available to the company and within the knowledge of the directors, at least 25% of the company's total issued share capital is held by the public.

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

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

AUDITORS

The financial statements for the year have been audited by KPMG who will retire at the annual general meeting and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors will be proposed at the forthcoming annual general meeting.



By Order of the Board
Christobelle Liao
Company Secretary
Hong Kong, 16 March 2006