

Chief Executive Officer's Report

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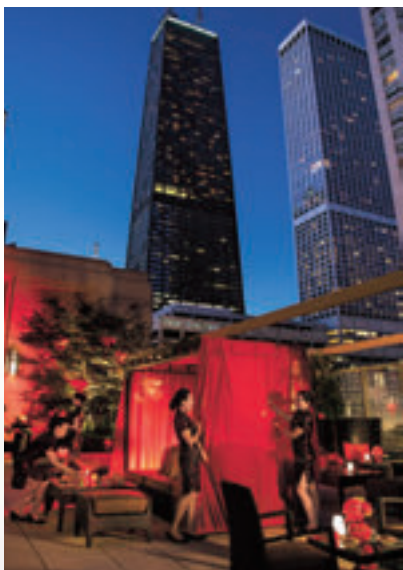


Clement K. M. Kwok
Chief Executive Officer

Overview

The theme of our Annual Report this year is Renovation and Innovation, reflecting the investment of financial and human resources which we have been making to renovate and upgrade our assets and in innovations to enhance our brand and guest experience. We have revitalised our two principal operating assets in Hong Kong and we have ushered in a range of new systems and technology to support future development across the Group.

As indicated in my Report last year, 2012 was a year of significant investment in the future of our Company through upgrading our rooms product in our flagship hotel, The Peninsula Hong Kong. Not only have we committed capital expenditure of HK\$450 million to this rooms renovation project, but 2012 bore the brunt of the consequent disruption in operating earnings from the closure of rooms. With the de Ricou serviced apartments at the Repulse Bay Complex also closed for a significant reconfiguration for 11 months of 2012, our financial objective was to maintain the same level of group operational earnings as was achieved in 2011 through improved performances from the other operations across our three



The Peninsula Moments Campaign

Divisions. I am pleased to report that this objective was achieved, with our EBITDA of HK\$1,201 million being almost flat as compared with last year.

Hotels

In general, the hotel markets in which we operate continued to recover from the aftermath of the global financial crisis which started in 2008-2009, although a number of our hotel properties have not recovered their earnings to the pre-crisis level. Specific factors have also affected some of our markets, such as the earthquake and tsunami in Japan and the floods in Thailand in 2011. Markets such as Beijing, Shanghai, Bangkok and Chicago have seen an abundance of new 5 star hotel



openings in recent years, giving rise to a highly competitive market environment. In 2012, strong financial performances were recorded by The Peninsula Hong Kong (despite the renovation) and The Peninsula Beverly Hills, whereas the best recovery from the previous year was recorded by The Peninsula Tokyo.

In September 2012, we launched a major new innovative global advertising campaign titled "Peninsula Moments". The images and videos, shot on location at the nine Peninsula Hotels around the world, showcased the special moments and memories which our hotels create for guests.

Chief Executive Officer's Report



The Peninsula Hong Kong

Hong Kong: The Peninsula Hong Kong began the first phase of its rooms renovation project in January 2012 and successfully completed it in September 2012. The 135 newly designed guestrooms in the Tower were complemented by a new Conference Centre which was converted from a floor of the Office Tower, a new Bar and a rejuvenated and significantly expanded Verandah restaurant. The renovated guestrooms have been extremely well received by guests and the early indications are that the average room rate achieved post-renovation

will be significantly above the rate pre-renovation. Overall, business continued to improve in both the corporate and leisure segments. The top producing markets for the hotel were Japan, China and the USA. There was also healthy growth from new customer markets including Russia and the Middle East. The food and beverage operations performed strongly, with the renovated and significantly expanded Verandah restaurant being very well received. The Peninsula Arcade remains highly sought after by leading luxury retail brands, with an average occupancy of 99% throughout the year, and both this and the Office Tower, which was fully let, were able to grow their average rent.



The Peninsula Shanghai

Mainland China: The Peninsula Shanghai, now in its third full year of operations and, we believe, is established as the best city hotel in mainland China as well as one of the leading hotels in the world. Despite intense competition from the large supply of new five star hotels in Shanghai, it continued to be the leader in RevPAR in Shanghai. The hotel enjoyed increased demand from domestic travellers and continued to step up its marketing efforts in mainland cities, as well as initiating partnerships with select high-end service providers. The Peninsula Arcade is occupied by 28 leading luxury retail brands. Meanwhile, The Peninsula Residences, which form part of this complex, commenced

leasing activities in 2012. Its premier address on the Bund has appealed to premium residential tenants and over 25% of the 39 units have been leased. **The Peninsula Beijing** was able to maintain a leading position in the capital despite intense competition from the large supply of other luxury hotels, and was able to achieve improvements in both RevPAR and occupancy. Following the completion of extensive upgrading work for the Peninsula Arcade, the Arcade's position as a pre-eminent luxury goods shopping venue in Beijing was further strengthened and several leading brands are in the course of expanding their stores, in two cases into triplex spaces. The Arcade continues to provide an important stream of revenue for the hotel.

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The Peninsula Residences



The Peninsula Beijing

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“The Peninsula Beverly Hills experienced a remarkable year, achieving the highest revenue, highest average daily rate and the highest number of days with full occupancy in the hotel’s 21-year history.”

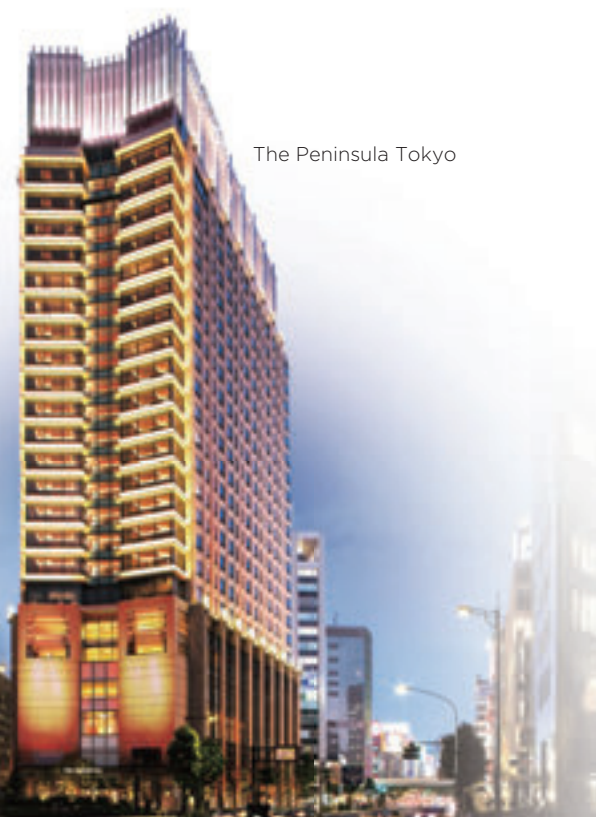


The Peninsula Bangkok

Asia: The Peninsula Tokyo

continued to face the challenge of an economy in recession and a persistently high Yen for most of the year, which impacted tourist arrivals, but business was buoyed by domestic demand. Besides the recovery from the previous year's earthquake and tsunami, the hotel also enjoyed a rebound due to major international conferences held in Tokyo, such as the World Travel & Tourism Congress in May and the International Monetary Fund-World Bank meeting in October, the latter of which helped to move the hotel's occupancies and average rates in that month to their highest level since the hotel opened in 2007. The hotel's wedding business was

also robust. The hotel continues to receive many accolades as one of the best hotels in Asia. In Thailand, **The Peninsula Bangkok** performed better than in 2011, with a stronger economy and rebounding from the massive floods in 2011. The new government appears to be more stable, although the political uncertainties of the past few years together with the increased supply of five star hotels, means that our



The Peninsula Tokyo



The Peninsula New York



The Peninsula Beverly Hills

earnings continue to be depressed as compared to the period prior to 2009. In The Philippines, **The Peninsula Manila** benefitted from a robust economy which boosted private spending, and saw an increase in frequent independent travellers' business while sustaining strong food and beverage business. The two recently created food and beverage outlets, Escolta and Salon de Ning, performed well.

USA: The Peninsula New York had a stable year, enjoying a good increase in business from some high-end overseas groups and expanding its business mix by focusing efforts on new sectors including technology, energy and entertainment. The renovation of the Peninsula Suite

was completed, marking the full completion of the hotel's latest guestroom renovation project. In late 2012, the hotel had to face the havoc brought about by Superstorm Sandy, which severely interrupted arrivals, but The Peninsula New York was one of the few five star hotels in New York City to maintain full service for guests throughout the storm. Plans are proceeding for a major revamp of the food and beverage facilities at the hotel. Business remained relatively weak for **The Peninsula Chicago**, which is highly dependent on domestic and corporate business, although there was some improvement in business in the second half of 2012. During the year,

The Peninsula Chicago renovated its Grand Suite and converted the Avenues restaurant into a junior ballroom, with great success. The hotel also hosted various national leaders and dignitaries who were in Chicago in May for the NATO Summit. In December, the hotel installed a skating rink outside Shanghai Terrace, which quickly became a popular feature in the city. In California, **The Peninsula Beverly Hills** experienced a remarkable year, achieving the highest revenue, highest average daily rate and the highest number of days with full occupancy in the hotel's 21-year history. The hotel continued to enjoy strong business from the entertainment industry and the Middle East market. Its guestroom renovation completed in 2011 is proving to be a success.

Overall, the revenue and EBITDA of the Hotels Division for the year were HK\$3,885 million and HK\$596 million respectively. Further details of individual hotel's financial performance can be found in the Financial Review (pages 38 to 42).

The Peninsula Chicago



Chief Executive Officer's Report

“The Commercial Properties Division continues to provide a stable income contribution to the Group's earnings, counter-balancing the more cyclical nature of hotel earnings.”

Commercial Properties

The Commercial Properties Division continues to provide a stable income contribution to the Group's earnings, counter-balancing the more cyclical nature of hotel earnings.

Our most important asset in this Division is **The Repulse Bay Complex**, whose major revenue is derived from residential lettings. During the year, lettings continued to experience strong demand, in line with Hong Kong's robust economy. In order to further enhance the yield from this Complex, we embarked

on a major reconfiguration of the de Ricou serviced apartment tower within this Complex. The shopping arcade enjoyed high occupancy throughout the year while banquet and wedding business also achieved a record high. A commemorative history book was published in the last quarter of the year to celebrate The Repulse Bay's rich history and development over the last 92 years. Due to the closure of the de Ricou tower for renovation for 11 months of 2012, the overall revenue of the Complex fell 4% from 2011 to HK\$518 million.

The Repulse Bay Complex





The Peak Complex



The Landmark

“The Peak Complex achieved excellent results in 2012 due to its strong positioning in the tourist market.”

The **Peak Complex** achieved excellent results in 2012 due to its strong positioning in the tourist market. The Peak Tower maintained an average occupancy of 99.6% throughout the year and recorded an increase of 8% in year-on-year revenue, which was also boosted by a higher number of visitors to the rooftop Sky Terrace 428. St. John's Building enjoyed a high occupancy of 91% throughout the year and revenue was in line with 2011.

At **The Landmark** in Vietnam, both the office and residential portions maintained high occupancies despite the intense competition in Ho Chi Minh City and a fragile national economy. We have been undertaking a renovation of the serviced apartments to maintain a highly competitive position in the city.

Overall, the revenue and EBITDA of the Commercial Properties Division for the year were HK\$733 million and HK\$474 million respectively. Further details of individual property's financial performance can be found in the Financial Review (pages 43 to 49).

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Cathay Pacific airport lounges



Thai Country Club

Clubs and Services

The historic **Peak Tram** has maintained its position as one of Hong Kong's most popular tourist attractions, welcoming thousands of visits every day from locals, tourists and even Chinese astronauts. In 2012, the patronage of the Peak Tram rose to a record 5.9 million passengers, a 2.4% increase from 2011. Revenue also grew by 6%.

Income from our club management activities rose with strong growth in utilisation of the **Cathay Pacific lounges** at the Hong Kong International Airport. The Wing, Cathay Pacific's first and business class lounges, partly re-opened during the year after extensive renovation with an upgrade in design and facilities and an enhanced food and beverage offer. The **Thai Country Club** saw an increase in the number of golf rounds played

as well as an increase in revenue. At **Quail Lodge & Golf Club**, the annual Quail Motorsports Gathering celebrated its 10th anniversary in August. We announced in the same month that we would be committing US\$28 million to renovating all of Quail's guestrooms, the lobby and golf course, following which the new Quail Lodge will re-open in March 2013. We have also appointed a specialist golf management

No.1 Waitanyuan





Quail Lodge & Golf Club



Peninsula Merchandising

company, KemperSports Management, to manage the golf and Clubhouse operations. In 2012, **Peninsula Merchandising** once again achieved record sales in Hong Kong and Asia for its signature Mid Autumn Festival mooncakes. We rebranded the range of products and franchised the first Peninsula Boutique in South Korea. In Shanghai, **No. 1 Waitanyuan**, managed by The Peninsula Shanghai, has gained a fine reputation for its fine food, service and ambiance in

the historic setting of the former British Consulate. We have also leased other premises within the Bund 33 complex for commercial usage.

Overall, the revenue and EBITDA of the Clubs & Services Division for the year were HK\$560 million and HK\$131 million respectively. Further details of individual clubs and services' financial performance can be found in the Financial Review (pages 44 to 45).

“The historic Peak Tram has maintained its position as one of Hong Kong’s most popular tourist attractions, welcoming thousands of visits every day.”

The Peak Tram



Chief Executive Officer's Report

“It has been a challenging and complicated project to convert this historic building into a Peninsula hotel. Since the commencement of the project, the scope of work has been expanded to address necessary additional structural works, historical preservation considerations, unknown site conditions and design improvements to the facilities for customers.”

Projects and Developments

The focus of our projects and development activities continues to be on (i) the establishment of a small and select number of new Peninsula hotels in key international gateway cities and (ii) continual enhancement of our existing hotels and other properties so as to maximise their long term value.

Since the beginning of 2009, we have been engaged in an ambitious project, in partnership with Katara Hospitality, to convert a beautiful historic building on Avenue Kleber in Paris, close to the Arc de Triomphe, to be The Peninsula Paris hotel. This hotel will be our first in Europe and promises to set new standards in terms of design, luxury and comfort. A huge amount of

work has been done by our project colleagues working in conjunction with Katara Hospitality and the project team in Paris. The project has now progressed to a stage where all of the main designs have been completed, the core of the building, its infrastructure and internal walls are close to completion and internal fitout is commencing.

However, it has been a challenging and complicated project to convert this historic building into a Peninsula hotel. Since the commencement of the project, the scope of work has been expanded to address additional structural works required, historical preservation considerations, unknown site conditions and design improvements to the facilities for customers. These issues have had consequences on timing, scope of consultants' services and contract costs. As a result, the total construction budget for the project was increased during the year from EUR295 million to EUR338 million (excluding contingency). The major part of the construction budget is being financed by a non-recourse project loan of EUR220 million which has been arranged. HSH owns 20% of the hotel.

Whilst the search for future new Peninsula hotel developments continue, we remain very selective in seeking opportunities in key gateway cities which will meet Peninsula's full requirements. A lot of time and effort goes into this endeavour and I hope to be able to report further progress in due course.



The Peninsula Paris

In the meantime, we continue to devote significant efforts to the continual enhancement of our existing assets. The second and final phase of the 15 month renovation in The Peninsula Hong Kong will be completed in the middle of 2013, which will return the remaining 165 guestrooms in the Original Building to inventory. The rooms in the Original Building incorporated the latest touch screen technology for our in-room controls which were developed by our in-house research and development department and are being built on the same design as the renovated guestrooms in the Tower, which as mentioned earlier are already commanding a significantly improved room rate, as compared to before the renovation. At the Repulse Bay Complex, the finalisation of the de Ricou renovation in the middle of 2013 will provide a more efficient mix of unfurnished and serviced apartments to replace the previous serviced apartment-only configuration, which we expect to increase the rental yield significantly for that asset. In addition, the final phase of ongoing renovation of the public areas in the Complex will further improve the living environment for our residents in the entire Complex.

We believe that the significant investment in The Peninsula Hong Kong and The Repulse Bay projects will further enhance the value of these key assets and help to maintain their leading positions in the market.

Projects and renovations continue to be undertaken regularly at all

“Our financial position remains strong. Our revalued net assets attributable to shareholders increased by 5% to HK\$36,390 million, representing HK\$24.23 per share, and our gearing remained at a conservative level of 6% at the year-end.”

properties in order to maximise usage and value of all areas. Other recently completed or ongoing projects include the renovation of the Peninsula Suite and the rejuvenation of the food and beverage facilities at The Peninsula New York, the creation of a junior ballroom at The Peninsula Chicago and the renovation of one of its Grand Suites, the renovation of all guestrooms at The Peninsula Beverly Hills completed during the year, the continual improvement of the retail arcade at The Peninsula Beijing, the renovation and re-opening of Quail Lodge and renovation of the serviced apartments at The Landmark in Ho Chi Minh City.

Financial Results

It continues to be a strength of our Group that our hotels business is balanced by a strong mix of commercial properties, including several successful high-end shopping arcades within our hotels, as well as our well-established commercial, residential and office properties. This comprehensive and diversified portfolio enables us to have balanced earnings over the long term.

Our Group results were impacted by the renovation work in The Peninsula Hong Kong, where 55% of the hotel room inventory was not available during 2012. The results, therefore,

reflect a 1% fall in earnings before interest, taxation, depreciation and amortisation (EBITDA) to HK\$1,201 million in 2012 and a fall of 2% in operating profit to HK\$817 million in 2012. The EBITDA margin was 23%. We regard this to be a satisfactory result in the light of the renovation disruptions during the year.

Inclusive of non-operating items, being principally the year-end investment property revaluation surpluses, the net profit attributable to shareholders was HK\$1,555 million, as compared to HK\$2,259 million in 2011. Our underlying profit attributable to shareholders, which we have calculated by excluding the post-tax effects of the property revaluation surpluses and other non-operating items, amounted to HK\$439 million, as compared to HK\$464 million in 2011, representing a fall of 5%.

Our financial position remains strong. Our revalued net assets attributable to shareholders increased by 5% to HK\$36,390 million, representing HK\$24.23 per share, and our gearing remained at a conservative level of 6% at the year-end. Our net cash outflow for the year, after deducting capital expenditure, interest and dividends, amounted to HK\$82 million.

Chief Executive Officer's Report

“Hong Kong remains the most important market for our businesses and it is pleasing and important to us that the economy here continues to be strong, providing stable demand for the retail spaces at The Peninsula Hong Kong, The Repulse Bay and the Peak Tower, as well as our residential and commercial lettings.”

Based on our results, the Board has recommended a final dividend payable on 20 May 2013 of 10 HK cents per share. Together with the 2012 interim dividend of 4 HK cents per share paid on 28 September 2012, the total dividend in respect of the 2012 financial year will be 14 HK cents per share.

Corporate Responsibility

In 2012, we continued to refine our approach to addressing our environmental, social and ethical responsibilities. Despite the Group's business growth, our absolute energy and water consumption in 2012 have reduced by 5.8% and 6.1% since 2008 when we began our sustainability programme. We have also become more conscious of our impact on the world's bio-diversity. In line with our efforts in responsible sourcing, we stopped serving shark fin at all our owned and managed food outlets around the world and launched a commitment to procure all paper products only from responsibly managed forests

by 2017. All Group companies have started to implement the policy during the year, with about 35% of paper product being FSC-certified, a 13% increase from the previous year.

I have always believed that the Group's sustainability journey would be made more focused by regular measurement of our progress. To further strengthen how we govern the environmental and social impact of our operations, we took an in-depth look at our sustainability management system and process in 2012. We expanded the reporting scope to cover more than 90% of the Group's businesses and reconsidered the metrics that we should use to give us greater clarity on our impacts. Some of the new reporting metrics were introduced during the year with the rest scheduled to roll out in 2013. We also renewed the discipline of tracking and driving our performance on a quarterly basis and introduced a new planning process of corporate responsibility initiatives in the annual budgetary exercise. The revamped and more robust

sustainability management processes underpin our commitment to integrating sustainable practices and principles across our businesses with balance and focus. In the coming years, we will work on expanding our employee engagement programme so as to bring this commitment to all parts of our business.

Developing a shared direction for sustainable business at the Group will be a focus of our work over the next two years. In 2012, we began engaging our management team around the world in a forum to assess key macro trends that will affect the Group's ability to continue to thrive in the long term. It was followed up by a structured process to engage our major stakeholder groups in developing our Sustainability Materiality Matrix. These efforts in building shared understanding both internally and with our external stakeholders, supported by the renewed sustainability management processes, have laid a solid foundation for us to explore a new vision of sustainable luxury for the Group.

Outlook

The strength of our Group continues to emanate from our genuine commitment to the long term, which provides the vision and willingness to invest in assets for their long term value creation and the staying power to ride through shorter term cycles in the economy without compromising the quality of our products and services. In the volatile economic circumstances that we regularly encounter in today's environment, this commitment has enabled us to make investment and capital expenditure decisions with a very long term outlook and to maintain our service quality and the continuity of our people. With this in mind, I remain optimistic that we are continuing to chart a course which will maximise the quality and value of our assets and deliver long term returns to our shareholders.

Our corporate development and investment strategy continues to focus on the enhancement of our existing assets, seeking opportunities to increase their value through new concepts or improved space utilisation, and the development of a small number of the highest quality Peninsula hotels in the most prime locations with the objective of being a long term owner-operator. 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, thereby creating value in each Peninsula hotel through both asset value appreciation and operational earnings growth.

For 2013, we are looking forward to bringing the entire room inventory of The Peninsula Hong Kong back into operation following the major renovation programme, which we expect will have a positive impact on earnings. The de Ricou reconfiguration will also be completed in the middle of the year, although with the time needed to build occupancy back up, we do not expect to benefit from the full impact of this until the following year. Following discussions with our joint venture partner in Shanghai, we have taken the decision to explore a potential sale of up to 49% of the Peninsula Residences within The Peninsula Shanghai Complex.

Other than these specific factors, the general market environment for most of our hotels remains stable to positive. However, we are watching with concern the territorial dispute between Japan and China which has already caused a reduction of travellers between these two countries. Our operating profit margins continue to be under pressure from rising wage costs and it remains of paramount importance to control costs and increase efficiency in delivering services to customers without any compromise to the quality of the experience of our guests.

Hong Kong remains the most important market for our businesses and it is pleasing and important to us that the economy here continues to be strong, providing stable demand for the retail spaces at The Peninsula Hong Kong, The Repulse Bay and

the Peak Tower, as well as our residential and commercial lettings. Inward tourism remains on a growth trend, to the benefit of our hotel as well as the Peak Tram and the Peak Tower. On a celebratory note, we will be celebrating the 125th anniversary of the Peak Tram and the 85th anniversary of The Peninsula Hong Kong this year.

Finally, at the heart of our brand are our people, who exemplify our values and beliefs in their dealings with our guests and in contributing to the communities in which we operate. It is the drive and creativity of our people which provide special and memorable experiences for our guests and develop for us the many meaningful and long lasting relationships which are important to our business. In turn, we are greatly committed to their well-being and development and emphasise staff welfare and training in all our activities. I would like to thank every member of our big staff 'family' for their hard work and commitment.



Clement K.M. Kwok
13 March 2013