

# Chief Executive Officer's Letter



## OVERVIEW

A significant milestone was reached in 2014 for the Company when, after almost 150 years of operations, we opened our first hotel in Europe, The Peninsula Paris. This hotel was the product of over four years of a meticulous and extensive construction project, during which we carefully restored the magnificent classic French-style building located close to the Arc de Triomphe and converted it into a grand contemporary hotel, whilst respecting the heritage, authenticity and spirit of the building. Since the hotel's opening on 1 August 2014, I am delighted that it has garnered a high level of acclaim from our guests and from the industry.

The Peninsula Paris project is a good example of our Company's philosophy towards development. We focus on undertaking only a very small number of

projects, but seek to do so as an owner-operator in exceptional locations where we believe we can create hotels that can rank among the world's best. Being an owner, in the case of The Peninsula Paris in partnership with Katara Hospitality, means that we are able to take a long-term view on the property investment and the hotel's operations. Our ultimate goal is to develop and hold the highest possible quality portfolio of hotel and other property assets for

the long term, in order to benefit from both operational yields and asset value appreciation over time.

In line with this objective, we are working in partnership with Grosvenor to develop The Peninsula London in an exceptional location in Belgravia overlooking Hyde Park Corner and in partnership with Yoma and First Myanmar Investment

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to develop The Peninsula Yangon in the former Myanmar Railway Company headquarters building in the centre of Yangon, Myanmar.

It is an important strand of our business strategy to continually improve and upgrade our existing assets. In this respect, we have commenced major renovation projects for The Peninsula Beijing and The Peninsula Chicago, with construction of both scheduled to start in 2015, as well as a renovation of our recently acquired investment property at 21 avenue Kléber, Paris.

While our overall business strategy is focused on long-term growth, we are of course seeking to maximise our operational earnings every year. In 2014, despite challenges to our business coming from the political uncertainty in Thailand, the unusually severe winter weather in the United States and continued oversupply in a number of our markets, I am delighted to report a substantial increase of 57% as compared to the previous year in our underlying profit attributable to shareholders to HK\$804 million. This result was achieved through the enhanced earnings of The Peninsula Hong Kong in its first full year of operations following its extensive rooms renovation project completed in May 2013, the continued improvement of the results of The Peninsula Tokyo and our overall efforts to drive revenues and contain costs around the Group.

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With the earnings achieved in 2014 together with a further upward revaluation of our investment property assets, the Group's financial position remained healthy with an adjusted net asset value of HK\$39,496 million (HK\$26.04 per share) and a modest gearing ratio of 8%.

## 2014 PERFORMANCE REVIEW

### Hotels

Overall it was a challenging year for the markets in which we operate. As usual, we continued to focus on driving revenue, containing costs and improving margins. As a result, our hotels division revenue increased by HK\$216 million (5%) over 2013 to HK\$4,260 million. The highest revenue growth was achieved by our flagship hotel, The Peninsula Hong Kong, where revenue was HK\$168 million (14%) higher than 2013. With its extensive rooms renovation project having been completed in May 2013, the hotel benefited from having its full room inventory for the whole year.

Although many Hong Kong businesses were negatively impacted in the fourth quarter of 2014 by the civil protests in the city, our hotel is located well away from the main protest areas and while there were some cancellations, the impact on our hotel was relatively minor. The Peninsula Hong Kong remains the market leader in terms of average room rates in the city and continues to receive many favourable comments for its renovated guest rooms and in-room technology. The Peninsula Hong Kong Arcade and Office Tower were fully occupied during the year, with leases in the arcade continuing to be renewed on favourable terms.

The Peninsula Shanghai enjoyed a positive year and remains the market leader in Shanghai in terms of RevPAR and average room rates. Its food and beverage outlets performed well during the year and its arcade continues to become more established as a high-end shopping destination. The Peninsula Tokyo's results were pleasing, with a 12% growth in revenue in Japanese Yen terms, in part due to the strengthening of the Japanese economy coupled with the more affordable currency. However, the weakening of the yen has reduced the growth in earnings to the group when translated back into Hong Kong dollars.

The Peninsula Beijing had a challenging year due to the over-supply of five-star hotels in the city. This hotel will undergo a major renovation and reconfiguration in 2015 and 2016, which will significantly increase the size of its guestrooms and bring them up to current Peninsula standards. The shopping arcade at The Peninsula Beijing remained one of the most sought-after luxury retail destinations in Beijing, enjoying full occupancy with many of the world's top brands present. I am pleased that the Arcade will remain open during the renovation project.

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The Peninsula Bangkok has been negatively affected by political uncertainties in Thailand on and off since 2008, with increased activity in February 2014 when a state of emergency was declared. This further dampened business for the year although a minor recovery was experienced towards the end of the year. The Peninsula Manila also faced challenges with an oversupplied and price sensitive market and natural disasters but achieved stable results for the year.

In the United States, the unusually harsh winter weather in the first quarter of 2014 affected bookings in Chicago and New York. The Peninsula New York nevertheless enjoyed a strong year with growth in RevPAR, occupancy growth and average room rates. In Chicago, room rates remained depressed with a weak corporate sector, coupled with strong competition from new luxury hotels, resulting in flat results as compared to the previous year. Plans are underway for us to significantly enhance our rooms product to regain our previous leading market position. The Peninsula Beverly Hills reported another record year on top of a record year in 2013, with very strong occupancy and average room rates increasing year-on-year.

The results of The Peninsula Paris have been pleasing since its opening on 1 August 2014. Although we would typically expect a new hotel to take some time to build up its business and customer base, the publicity and attention which The Peninsula Paris received upon its opening has resulted in both rooms and food and beverage revenue exceeding our expectations. The opening of this hotel has established the Peninsula brand in Europe and introduced a new clientele to our Group's hotels.

## **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. Total revenue from this division increased by HK\$95 million (12%) over 2013 at HK\$901 million.

The luxury residential market in Hong Kong remained uncertain in 2014, due to the slowing of the financial markets and a reduction in the number of expatriates receiving high rental allowances. The Repulse Bay Complex, our key asset in this division, offers extensive facilities and a market-leading product with the newly renovated de Ricou Tower, and we achieved satisfactory occupancy levels in 2014 despite the flat market situation. The Complex reported 8% higher revenue over 2013 due to increased rental income from apartments, with a pleasing pick-up in the occupancy of the de Ricou apartment tower following its renovation and reconfiguration which was completed in 2013.

Both the Peak Tower and St John's Building remained fully let in 2014, reporting revenue growth of 12% and 11% respectively. The Peak Tower generates most of its revenue from retail leasing, with additional revenue being derived from entrance fees to the open-air Sky Terrace 428 with its panoramic views of Hong Kong.

The Landmark in Ho Chi Minh City, Vietnam, celebrated its 20<sup>th</sup> anniversary in December 2014. A mixed-use commercial building comprised of serviced apartments, offices and retail space, its revenue in 2014 was flat as compared to the previous year.

Rental income from 1-5 Grosvenor Place in London and 21 avenue Kléber in Paris also contributed to the commercial properties division this year from their respective dates of acquisition. Our 50% interest in the leasehold of 1-5 Grosvenor Place was acquired with the intention that this property would be redeveloped in partnership with Grosvenor into The Peninsula London hotel and residential complex. 21 avenue Kléber is wholly-owned and was acquired as an investment property due to its location immediately adjacent to The Peninsula Paris. With its previous main tenant vacating at the end of 2014, we have plans to renovate the building to enhance its attractiveness to future retail and office tenants.

## **Clubs and Services**

The Group's diverse portfolio is complimented by our Clubs and Services division, which reported an increase in total revenue of 3% to HK\$677 million in 2014.

Peninsula Clubs and Consultancy Services maintained a consistent portfolio in 2014, providing club management services for several prestigious private clubs in Hong Kong, as well as Cathay Pacific Lounges at Hong Kong International Airport.

The historic Peak Tram has maintained its position as one of Hong Kong's most popular tourist attractions, welcoming tens of thousands of visits every day from locals and tourists alike. In 2014, The Peak Tram reported an increase of 1% in patronage, giving rise to revenue growth of 2%. As previously reported, the Ordinance which grants HSH the right to operate the Peak Tram was temporarily extended until 31 December 2015 pending the Hong Kong Government's review and appraisal of the proposal which we have submitted to improve and enlarge the capacity of The Peak Tram. We expect that in conjunction with this investment proposal, the Government will propose legislation to grant us another long-term operating licence for the Tram.

Peninsula Merchandising achieved record sales in Hong Kong and Asia for its signature Mid-Autumn Festival mooncakes, contributing to a revenue growth of 3%. The Thai Country Club was negatively impacted by the ongoing political uncertainties in Thailand. Tai Pan Laundry's revenue increased by 10% over the same period last year.

### **Projects and Developments**

The highlight of the year was the completion of The Peninsula Paris project in time for its opening on 1 August 2014. We have invested a substantial amount of time and resources into this project since signing the agreement in January 2009 for the redevelopment of this magnificent historic French building into The Peninsula Paris. Construction of the project commenced in 2010 and the scope of work has included large-scale technical and engineering work to reconstruct and strengthen the entire building, excavating basement levels and adding extensive technological facilities to bring the building into the 21st century, whilst respecting and preserving many elements of historical interest in the building. I am pleased to report that the project has been completed within the revised budget of €429 million (excluding contingencies) as reported in last year's annual report. HSH's shareholding interest in this freehold project is 20%.

The Peninsula London project was entered into in July 2013 and is a 50/50 partnership with Grosvenor in the 150 year leasehold of 1-5 Grosvenor Place, situated in an exceptional location in Belgravia overlooking Hyde Park Corner. Subject to planning consent from the London authorities, the intention is to demolish the existing building and to build in its place a mixed use complex comprising The Peninsula London hotel and residential apartments for sale. Our interest in the building was acquired for £132.5 million and we are currently finalising the overall timetable and budget for the redevelopment, as well as the designs and plans to be submitted in order to seek planning approval in London.

In order to expand our presence into one of the world's most exciting developing markets, we announced in January 2014 a conditional shareholders' agreement with Yoma Strategic Holdings Ltd. and First Myanmar Investment Co., Ltd. to acquire a 70% interest in the leasehold of the former Myanmar Railway Headquarters in the centre of Yangon, Myanmar, with the intention of restoring the building and converting it into a hotel to be called The Peninsula Yangon. Preparatory work has been undertaken to establish a programme for the development of this asset upon final satisfaction of the remaining conditions to the agreement. It is expected that the hotel budget and timetable will be finalised after the agreement becomes unconditional.

The major RMB 890 million renovation for The Peninsula Beijing is due to begin in 2015. The design process and preparations are well underway for the renovation which will significantly enhance the guest rooms and public areas of the hotel up to current Peninsula standards, with most room sizes being doubled by combining two existing guestrooms into one larger guestroom. We believe that the resultant product will place us at the top of the Beijing market, as has been experienced with The Peninsula Shanghai. In Chicago, the US\$35.7 million guestroom renovation programme will begin in 2015 and will result in a complete refit of all guestrooms up to current Peninsula standards. After these renovations, both The Peninsula Beijing and The Peninsula Chicago will have our latest in-room technology installed, offering easy-to-use tablet controls in 11 different languages.

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## SUSTAINABLE LUXURY

We unveiled our Sustainable Luxury Vision 2020 in 2013, setting out our blueprint for sustainable growth and our ambition to achieve a new level of sustainable luxury. As the first full year of our journey towards Vision 2020, our focus in 2014 was on laying the foundations for achieving our long-term goals. This involved developing action plans and implementation guides to drive success, enhancing our reporting system to track our progress, and embedding Vision 2020 into our management decision processes.

To deliver on both luxury and sustainability is challenging. There will be successes and setbacks in our path towards Vision 2020 and 2014 was a year in which we embraced both. For example, our hotels division made good progress in improving water efficiency whereas our energy management performance fell short of the targets we had set. We were one of the first companies in the world to comply with the new Global Reporting Initiative (GRI) G4 reporting standards starting in 2013 and to be verified by GRI on our report's Materiality Disclosures. Our Sustainability Review on pages 56 to 108 contains detailed data and reports on all of our activities.

## FINANCIAL RESULTS

In 2014, we achieved earnings before interest, taxation, depreciation and amortisation (EBITDA) of HK\$1,528 million, representing a significant increase of 17% over 2013. Underlying profit attributable to shareholders increased by 57% to HK\$804 million.

Based on our results, the Board has recommended a final dividend payable on 19 June 2015 of 18HK cents per share. Together with the 2014 interim dividend of 5HK cents per share paid on 31 October 2014, the total dividend in respect of the 2014 financial year will be 23HK cents per share, an increase of 44% as compared to last year.

## FUTURE PROSPECTS

The strength of our Group continues to emanate from our genuine commitment to a long-term future. This 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.

In 2015, our operating results will be adversely affected by the partial closure of The Peninsula Beijing and the disruption to The Peninsula Chicago as a result of their renovation projects. Also, I believe that the outlook for the Hong Kong market in terms of high-end residential lettings and retail rental income is somewhat uncertain. We have experienced a mixed start to our businesses in 2015 and will have to work hard to drive revenues and contain costs across all of our operations to compensate for the earnings disruptions in Beijing and Chicago as mentioned above.

Taking a wider and longer term view, I am optimistic that the actions we have taken over the years will result in attractive long-term growth and development for our Company. The Peninsula Hong Kong is well placed in its market following the extensive renovation project completed in 2013 and all of our three more recently opened hotels, The Peninsulas in Tokyo, Shanghai and Paris, have become well established in their markets with good growth prospects. The extensive renovations in Beijing and Chicago will significantly enhance the competitiveness of those hotels and we are excited about the quality of the upcoming developments in London and Yangon, Myanmar. At the same time, our hotels business is well balanced by the more stable earnings that are generated by our investment property division, particularly the Repulse Bay Complex and the Peak Complex.

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Our long-term growth is underpinned by a strong balance sheet comprising valuable high quality assets coupled with a low level of gearing, as well as our dedicated team of management and staff around the world who understand and respect our heritage and serve the Group with loyalty.

I would like to thank my Board members for their support and guidance and all of my colleagues around the world for their hard work and commitment. We are proud of their achievements and I look forward to working and developing together with our great team for years to come.



*Clement K.M. Kwok*  
*20 March 2015*