Financial Review

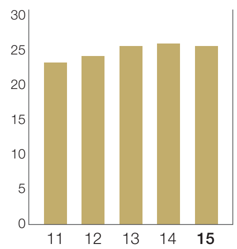
The financial details outlined in this chapter provide an overview of the Group's consolidated results and financial capital as categorised by the International Integrated Reporting Framework, which refers to the pool of funds that is available to an organisation for use in the production of goods or the provision of services.

ADJUSTED NAV

HK$39,627m +0.3%

Adjusted NAV per share

HK$



The Group's adjusted net asset value

In the Financial Statements, the Group's hotels (other than shopping arcades and offices within the hotels) and golf courses are stated at depreciated cost less accumulated impairment losses, if any, and not at fair value.

Accordingly, we have commissioned an independent third-party fair valuation of the Group's hotels and golf courses as at 31 December 2015, the details of which are set out on page 61. If these assets were to be stated at fair value, the Group's net assets attributable to shareholders would increase by 9% to HK$39,627 million as indicated in the table below.

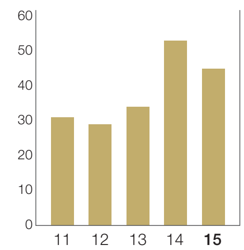
HK$m		**2015**		2014
Net assets attributable to shareholders per the audited statement of financial position		**36,427**		35,901
Adjusting the value of hotels and golf courses to fair value	**3,685**		4,378	
Less: Related deferred tax and non-controlling interests	**(485)**		(783)	
		3,200		3,595
Adjusted net assets attributable to shareholders		**39,627**		39,496
Audited net assets per share (HK$)		**23.61**		23.67
Adjusted net assets per share (HK$)		**25.68**		26.04

UNDERLYING EARNINGS

HK$688m -14%

Underlying Earnings per share

HK cents



The Group's underlying earnings

Our operating results are mainly derived from the operation of hotels and letting of commercial properties. We manage the Group's operations with principal reference to their underlying operating cash flows and recurring earnings. However, to comply with the applicable accounting standards, we are required to include non-operating and non-recurring items, such as any changes in fair value of investment properties, in our income statement. In order to provide a better reflection of the performance of the Group, we have provided calculations of the Group's underlying profit attributable to shareholders and underlying earnings per share, which are determined by excluding the post-tax effects of the property revaluation movements and other non-operating and non-recurring items.

The Group's underlying profit attributable to shareholders for the year ended 31 December 2015 amounted to HK$688 million, a decrease of 14% compared to 2014, mainly due to the renovations at the Peninsula hotels in Beijing and Chicago and the declining tourist arrivals in Hong Kong.

HK$m	2015	2014	2015 vs 2014
Profit attributable to shareholders	**1,000**	1,146	
Increase in fair value of investment properties, net of tax and non-controlling interests	**(295)**	(490)	
Share of property revaluation loss/(gain) of The Peninsula Shanghai, net of tax	**37**	(6)	
Effect of decrease in tax rates on deferred tax liabilities arising from revaluation gains on investment properties	**(54)**	–	
Provision for impairment loss in respect of The Peninsula Beijing and The Peninsula Manila	**–**	132	
Other non-operating and non-recurring items	**–**	22	
Underlying profit attributable to shareholders	**688**	804	(14%)
Underlying earnings per share (HK$)	**0.45**	0.53	(15%)

Income statement

The Group's consolidated income statement for the year ended 2015 is set out on page 156. The following table summarises the key components of the Group's profit attributable to shareholders. This table should be read in conjunction with the commentaries set out on pages 56 to 59 of this Financial Review.

HK$m	2015	2014	2015 vs 2014
Revenue	**5,741**	5,838	(2%)
Operating costs	**(4,301)**	(4,310)	–
EBITDA	**1,440**	1,528	(6%)
Depreciation and amortisation	**(426)**	(423)	1%
Net financing charges	**(68)**	(66)	3%
Share of result of The Peninsula Shanghai*	**(71)**	(6)	1,083%
Share of results of The Peninsula Paris and The Peninsula Beverly Hills**	**(23)**	(35)	(34%)
Non-operating items	**277**	364	(24%)
Taxation	**(124)**	(231)	(46%)
Profit for the year	**1,005**	1,131	(11%)
Non-controlling interests	**(5)**	15	(133%)
Profit attributable to shareholders	**1,000**	1,146	(13%)

* Being the Group's 50% share of The Peninsula Shanghai's (PSH) result. The 2015 figure includes the Group's share of unrealised loss of HK$37 million (2014: unrealised gain of HK$6 million) arising from the revaluation of PSH's investment properties, net of tax.

** Being the Group's 20% share of The Peninsula Paris' (PPR) operating loss net of its 20% share of The Peninsula Beverly Hills' profit. PPR opened for business on 1 August 2014 and the 2014 comparative figure includes the Group's 20% share of pre-opening expenses of the hotel.

REVENUE

HK$5,741m -2%

Hotels

HK$4,073m -4%

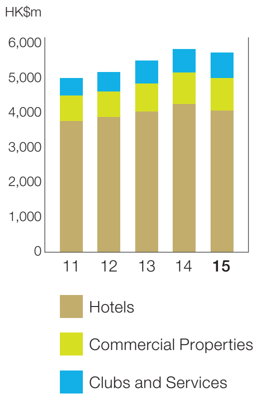
Commercial Properties

HK$937m +4%

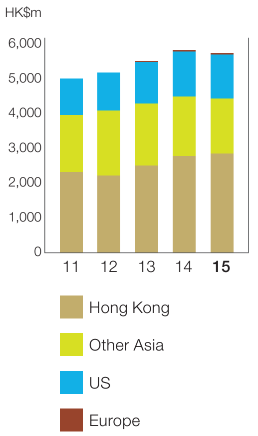
Clubs and Services

HK$731m +8%

Consolidated Revenue by Business Segment



Consolidated Revenue by geographical segment



Revenue

The Group's revenue in 2015 decreased by 2% to HK$5,741 million. A breakdown of this by business segment and geographical segment is set out in the following table:

Consolidated revenue by business segment

HK$m	**2015**	2014	2015 vs 2014
Hotels	**4,073**	4,260	(4%)
Commercial Properties	**937**	901	4%
Clubs and Services	**731**	677	8%
	5,741	5,838	(2%)

Consolidated revenue by geographical segment

HK$m	**2015**	2014	2015 vs 2014
Arising in			
Hong Kong	**2,851**	2,775	3%
Other Asia	**1,581**	1,718	(8%)
United States of America	**1,273**	1,290	(1%)
Europe	**36**	55	(35%)
	5,741	5,838	(2%)

The hotels division is the main contributor to the Group's revenue, accounting for 71% (2014: 73%) of total revenue. The operating performance of the Group's hotel businesses is subject to a higher degree of volatility by nature. The decrease in revenue of the hotels division was due to a combination of factors, including the room closures for the renovation programmes undertaken by The Peninsula Beijing and The Peninsula Chicago, and declining tourist arrivals in Hong Kong. The devaluation of Renminbi and Japanese Yen has also contributed to the decrease in revenue of the hotels division.

The increase in revenue for the commercial properties was mainly due to the increased occupancy achieved by The Repulse Bay Complex. The increase in revenue for the clubs and services division was due to higher mooncake sales achieved by Peninsula Merchandising and better results achieved by Quail Lodge following its renovation of the golf course.

Details of the operating performances of the Group's individual operations are set out on pages 28 to 48 of the CEO's Strategic Review.

Operating costs

In 2015, our operating costs (excluding depreciation and amortisation) decreased marginally to HK$4,301 million (2014: HK$4,310 million).

Given the nature of operating high-end luxury hotels, staff costs continued to be the largest portion of operating costs. Staff costs and related expenses for the year increased by 1% to HK$2,063 million, representing 48% (2014: 48%) of the Group's operating costs and 36% (2014: 35%) of the Group's revenue.

EBITDA and EBITDA Margin

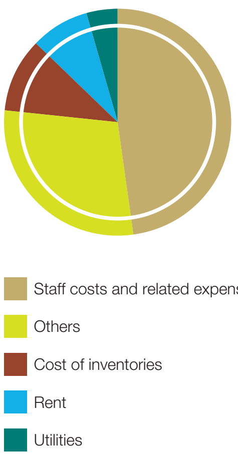
EBITDA (earnings before interest, taxation, depreciation and amortisation) of the Group decreased by HK$88 million or 6% to HK$1,440 million in 2015. The table below sets out the breakdown of the Group's EBITDA by business segment and by geographical segment.

EBITDA (HK$m)	Hong Kong	Other Asia	United States of America	Europe	Total
2015					
Hotels	**536**	**161**	**16**	**–**	**713**
Commercial Properties	**555**	**16**	**–**	**25**	**596**
Clubs and Services	**132**	**10**	**(11)**	**–**	**131**
	1,223	**187**	**5**	**25**	**1,440**
	85%	**13%**	**–**	**2%**	**100%**
2014					
Hotels	565	209	44	–	818
Commercial Properties	524	16	–	42	582
Clubs and Services	130	9	(11)	–	128
	1,219	234	33	42	1,528
	80%	15%	2%	3%	100%
Change 2015 vs 2014	–	(20%)	(85%)	(40%)	(6%)

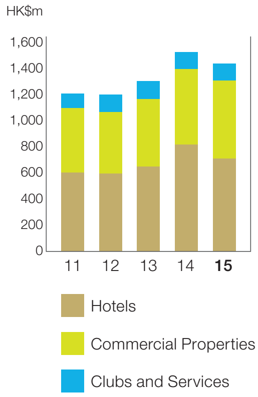
EBITDA Margin	**2015**	2014
Hotels	**18%**	19%
Commercial Properties	**64%**	65%
Clubs and Services	**18%**	19%
Overall EBITDA margin	**25%**	26%
Arising in		
Hong Kong	**43%**	44%
Other Asia	**12%**	14%
United States of America	**–**	3%
Europe	**69%**	76%

OPERATING COSTS

HK$4,301m -0.2%



EBITDA by Business Segment



The luxury hotel business is a labour-intensive industry with a high fixed cost base. With continuous efforts to certain costs, the Group was able to limit the decrease in the hotels division's EBITDA margin by one percentage point compared to a four percent decrease in hotel revenue, mainly caused by renovations to The Peninsula Beijing and The Peninsula Chicago. The decrease in the EBITDA margin for the commercial properties division was mainly due to a reduction in rental income from 21 avenue Kléber, following the departure of its main tenant in December 2014 ahead of the renovation of this property. The clubs and services division's EBITDA margin decreased by one percentage point to 18%, mainly due to high operating costs of The Peak Tram and Quail Lodge & Golf Club.

Depreciation and amortisation

The depreciation and amortisation charge of HK$426 million (2014: HK$423 million) largely relates to hotels. Depreciation charges are substantial and as such the Group adopts a rolling 5-year capital expenditure plan that is reviewed regularly to monitor planned replacement of furniture, fixtures and equipment, purchase of new items and major upgrade or enhancement projects.

Non-operating items

The non-operating items are analysed as follows:

HK$m	**2015**	2014
Increase in fair value of investment properties	**277**	496
Provision for impairment loss	**–**	(132)
	277	364

The increase in fair value of investment properties for the year was principally attributable to the increase in the appraised market value of The Repulse Bay Complex. In 2014, the Directors considered that the book values of The Peninsula Beijing and The Peninsula Manila as at 31 December 2014 were higher than their respective recoverable amounts. On this basis, the book values of these hotels were written down by HK$132 million.

Share of results of The Peninsula Shanghai

The Group, through its joint venture The Peninsula Shanghai Waitan Hotel Company Limited (PSW), owns a 50% interest in The Peninsula Shanghai Complex which comprises a hotel, a shopping arcade and a residential tower of 39 apartments, of which 19 apartment units were reclassified as apartments held for sale in 2013.

During 2015, The Peninsula Shanghai remained the market leader in terms of average room rate and RevPAR in its competitor set, generating an EBITDA of HK$159 million (2014: HK$247 million), of which HK$35 million (2014: HK$129 million) was derived from the sale of two apartment units (2014: 11 apartment units). In addition, The Peninsula Shanghai Complex recorded a net unrealised loss of HK$74 million on revaluation of the hotel arcade (2014: a net unrealised gain of HK$12 million). As PSW has been mainly debt financed and its hotel building is subject to a high depreciation charge given the remaining lease term, PSW made a net loss of HK$142 million (2014: HK$12 million) after accounting for the unrealised revaluation loss, depreciation and financing charges. The Group's share thereon amounted to HK$71 million (2014: HK$6 million).

Details of the operating performance of The Peninsula Shanghai are set out in the CEO's Strategic Review section on pages 32 to 33.

Share of results of The Peninsula Beverly Hills and The Peninsula Paris

The Group has a 20% interest in each of The Peninsula Beverly Hills and The Peninsula Paris. The Group's share of net loss of these two hotels for 2015 amounted to HK$23 million (2014: HK$35 million, of which HK$22 million related to the share of pre-opening expenses incurred by The Peninsula Paris which opened for business on 1 August 2014).

Details of the operating performances of The Peninsula Beverly Hills and The Peninsula Paris are set out in the CEO's Strategic Review section on pages 40 to 41.

Statement of financial position

The Group's financial position as at 31 December 2015 remained strong, with a year-on-year increase in shareholders' funds of 1% to HK$36,427 million, representing a per share value of HK$23.61 compared to HK$23.67 in 2014. The consolidated statement of financial position of the Group as at 31 December 2015 is presented on page 158 and the key components of the Group's assets and liabilities are set out in the table below:

HK$m	**2015**	2014	2015 vs 2014
Fixed assets	**39,097**	38,168	2%
Other long-term assets	**2,169**	2,474	(12%)
Cash at banks and in hand	**2,919**	2,477	18%
Other assets	**904**	863	5%
	45,089	43,982	3%
Interest-bearing borrowings	**(6,192)**	(5,481)	13%
Other liabilities	**(2,237)**	(2,350)	(5%)
	(8,429)	(7,831)	8%
Net assets	**36,660**	36,151	1%
Represented by			
Shareholders' funds	**36,427**	35,901	1%
Non-controlling interests	**233**	250	(7%)
Total equity	**36,660**	36,151	1%

Fixed assets

The Group has interests in ten operating hotels in Asia, US and Europe. In addition to hotel properties, the Group owns residential apartments, office towers and commercial buildings for rental purposes.

Our hotel properties and investment properties are dealt with under different accounting policies as required by the accounting standards. The hotel properties (other than shopping arcades and offices within the hotels) and golf courses are stated at cost less accumulated depreciation and any provision for impairment losses whilst investment properties are stated at fair value. Therefore, independent valuers have been engaged to conduct a fair valuation of the hotel properties and golf courses as at 31 December 2015, and a summary of the Group's hotel, commercial and other properties showing both the book value and the fair value as at 31 December 2015 is set out in the table on the following page.

	Group's interest	Value of 100% of the property: Fair value valuation (HK$m)	Value of 100% of the property: Book value (HK$m)
Hotel properties *			
The Peninsula Hong Kong	100%	12,084	9,989
The Peninsula New York	100%	2,414	1,741
The Peninsula Tokyo	100%	1,458	1,420
The Peninsula Chicago	100%	1,340	1,221
The Peninsula Beijing	76.6%**	1,321	1,156
The Peninsula Bangkok	75%	597	595
The Peninsula Manila	77.4%	163	160
		19,377	16,282
Commercial properties			
The Repulse Bay Complex	100%	16,862	16,862
The Peak Tower	100%	1,345	1,345
St. John's Building	100%	967	967
21 avenue Kléber	100%	509	509
1-5 Grosvenor Place	50%	3,278	3,278
The Landmark	70%$^{\Delta}$	77	77
		23,038	23,038
Other properties			
Thai Country Club golf course	75%	210	237
Quail Lodge resort, golf course and vacant land	100%	305	289
Vacant land in Thailand	75%	382	382
Others	100%	335	225
		1,232	1,133
Total market/ book value		43,647	40,453
Hotel and investment property held by a joint venture			
The Peninsula Shanghai Complex $^{\Delta\Delta}$	50%	4,895	4,628
Hotel properties held by associates			
The Peninsula Paris	20%	5,517	5,347
The Peninsula Beverly Hills	20%	2,636	467

* Including the shopping arcades and offices within the hotels.

** The Group owns 100% economic interest of The Peninsula Beijing with a reversionary interest to the PRC partner in 2033 upon expiry of the co-operative joint venture period.

Δ The Group owns 50% economic interest of The Landmark with a reversionary interest to the Vietnamese partner in 2026 upon expiry of the joint venture period.

$\Delta\Delta$ Excluding the remaining 6 apartment units held for sale.

Other long-term assets

The other long-term assets as at 31 December 2015 of HK$2,169 million (2014: HK$2,474 million) principally comprise the Group's 50% interest in The Peninsula Shanghai, the Group's 20% interest in The Peninsula Paris (PPR) and the hotel operating right in respect of PPR. The decrease in balance was mainly due to the exchange on translation of the Group's investment in PPR and the related hotel operating right resulting from the weakening of the Euro exchange rate. The exchange differences were accounted for as other comprehensive income in 2015.

Cash at banks and in hand and interest-bearing borrowings

As at 31 December 2015, the Group's cash at banks and in hand and interest-bearing borrowings amounted to HK$2,919 million (2014: HK$2,477 million) and HK$6,192 million (2014: HK$5,481 million) respectively. The increase in interest-bearing borrowings was mainly due to the drawdown of a new JPY11 billion term loan to fund the acquisition of The Peninsula Tokyo's hotel building. A breakdown of the Group's capital expenditure for the year ended 31 December 2015 is set out on page 63.

Cash flows

The consolidated statement of cash flows of the Group for the year ended 31 December 2015 is set out on page 160. The following table summarises the key cash movements for the year ended 31 December 2015.

HK$m	**2015**	2014
EBITDA	**1,440**	1,528
Net change in working capital	**4**	61
Tax payment	**(224)**	(157)
Net cash generated from operating activities	**1,220**	1,432
Capital expenditure on existing assets	**(476)**	(370)
Net cash inflow after normal capital expenditure	**744**	1,062
Capital expenditure on new projects	**(67)**	(39)
Acquisition of new properties including The Peninsula Tokyo's hotel building	**(849)**	–
Net cash (outflow)/inflow before dividends and other payments	**(172)**	1,023

The increase in current tax payment was mainly due to the higher tax payments by The Peninsula Hong Kong and The Repulse Bay Complex. The tax payments of these two Hong Kong operations were lower in the previous year due to the depreciation allowances in respect of cost of renovation to the properties.

The after-tax net cash generated from operating activities for the year amounted to HK$1,220 million (2014: HK$1,432 million), of which HK$476 million (2014: HK$370 million) was applied to fund capital expenditure on existing assets.

The breakdown of the Group's spending on its existing assets and the new acquisitions is analysed below:

HK$m	**2015**	2014
Hotels		
Renovations for The Peninsula Beijing and The Peninsula Chicago	**195**	76
Others	**139**	181
Commercial properties	**77**	66
Clubs and services	**65**	47
	476	370
New projects and acquisitions		
Capital expenditure on new projects	**67**	39
The Peninsula Tokyo's hotel building	**732**	–
A property in Hong Kong	**117**	–
	916	39
	1,392	409

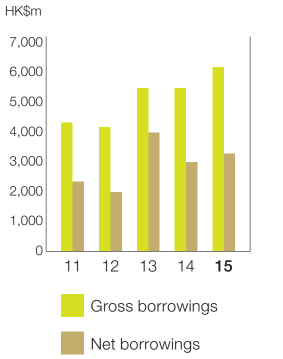
Capital and treasury management

The Group is exposed to liquidity, foreign exchange, interest rate and credit risks in the normal course of business and have policies and procedures in place to manage such risks.

The Group manages treasury activities centrally at its corporate office in Hong Kong. The Group also regularly reviews its capital structure and actively monitors current and expected liquidity requirements to ensure its obligations and commitments are met. A proactive approach is taken to forecasting future funding requirements and, when funds are needed, market conditions are evaluated to determine the best form of finance to be secured.

In addition, the Group maintains sufficient cash reserves and adequate committed banking facilities from major financial institutions to ensure funds are available to meet its financial obligations and to finance its growth and development.

Gross and Net Borrowings

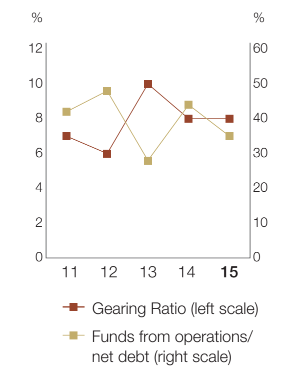


Liquidity/financing

The Group monitors its capital structure on the basis of its gearing ratio, which is expressed as the percentage of net borrowings (defined as interest-bearing borrowings less cash at bank and in hand) to the total of net borrowings and equity attributable to shareholders of the Company.

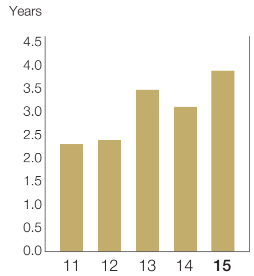
In 2015, gross borrowings increased to HK$6,192 million (2014: HK$5,481 million) mainly due to the drawdown of a new JPY 11 billion term loan to fund the acquisition of the hotel building of The Peninsula Tokyo. Consolidated net debt increased to HK$3,273 million as compared to HK$3,004 million in 2014, after taking into account cash of HK$2,919 million (2014: HK$2,477 million). Despite the increase in net borrowings, the Groups's net gearing remained at 8%, whilst the funds from operations (EBITDA less tax paid and less net interest paid) to net debt ratio decreased from 44% to 35%. These ratios continue to reflect a healthy financial position for the Group.

Gearing and Funds from Operations to Net Debt

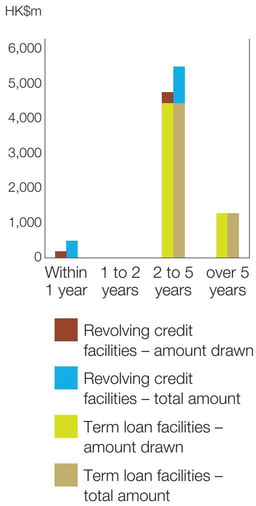


The average debt maturity increased from 3.1 years to 3.9 years.

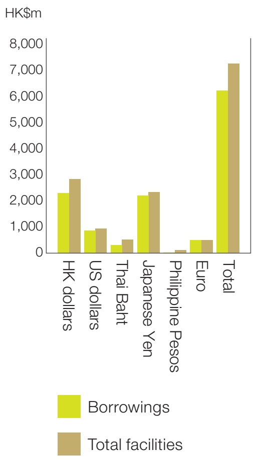
Average Debt Maturity



Banking Facilities and Borrowings (by type and maturity)



Banking Facilities and Borrowings (by currency)



Apart from a new credit facility of JPY11 billion obtained for the acquisition of the hotel building for The Peninsula Tokyo, the Company also arranged credit facilities of JPY12 billion and US$80 million respectively for two wholly owned subsidiaries and a credit facility of PHP700 million for a subsidiary to refinance their maturing loans.

In addition to the Group's consolidated borrowings, The Peninsula Shanghai (50% owned), The Peninsula Beverly Hills (20% owned) and The Peninsula Paris (20% owned) have non-recourse bank borrowings which are not consolidated in the statement of financial position as the entities owning the assets are not subsidiaries of the Company.

The consolidated and non-consolidated borrowings as at 31 December 2015 are summarised as follows:

	2015					2014
HK$m	**Hong Kong**	**Other Asia**	**United States of America**	**Europe**	**Total**	Total
Consolidated gross borrowings	**2,287**	**2,538**	**862**	**505**	**6,192**	5,481
Non-consolidated gross borrowings attributable to the Group*						
The Peninsula Shanghai (50%)	**–**	**1,088**	**–**	**–**	**1,088**	1,183
The Peninsula Beverly Hills (20%)	**–**	**–**	**219**	**–**	**219**	224
The Peninsula Paris (20%)	**–**	**–**	**–**	**370**	**370**	409
Non-consolidated borrowings	**–**	**1,088**	**219**	**370**	**1,677**	1,816
Consolidated and non-consolidated gross borrowings	**2,287**	**3,626**	**1,081**	**875**	**7,869**	7,297

* Represents HSH's attributable share of borrowings

Foreign exchange

The Group reports its financial results in Hong Kong dollars and does not hedge US dollar exposures in the light of the HK-US dollar peg. It usually hedges most of the foreign exchange exposures arising from significant foreign currency monetary assets and liabilities, including foreign currency borrowings. The Group mostly uses cross currency swaps, foreign exchange swaps or forward exchange contracts to hedge exposures.

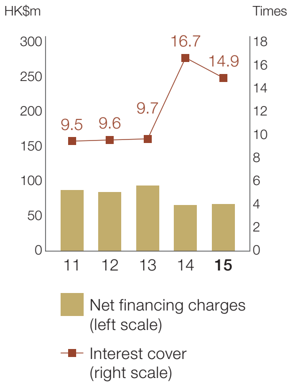
All of the Group's borrowings are denominated in the functional currency of the operations to which they relate. As at 31 December 2015, Hong Kong dollar borrowings represented 37% (2014: 42%) of total borrowings. Other balances were mainly in US dollars, Japanese yen and other local currencies of the Group's entities.

Interest rate risk

The Group has an interest rate risk management policy which focuses on reducing the Group's exposure to changes in interest rates by maintaining a prudent mix of fixed and floating rate liabilities. In addition to raising funds directly on a fixed rate basis, the Group also uses interest rate swaps or cross currency interest rate swaps in managing its long-term interest rate exposure.

Financing charges on borrowings in 2015 amounted to HK$124 million (2014: HK$131 million). After interest income of HK$56 million (2014: HK$65 million), a net charge of HK$68 million (2014: HK$66 million) was recognised in the income statement. Interest cover (operating profit divided by net financing charges) decreased to 14.9 times (2014: 16.7 times) in 2015. As at 31 December 2015, the Group's fixed to floating interest rate ratio increased to 62% (2014: 44%) whilst the weighted average gross interest rate for the year decreased from 2.3% to 2.2%.

Net Financing Charges and Interest Cover



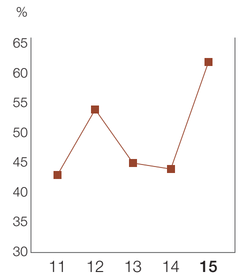
Credit risk

The Group manages its exposure to non-performance of counterparties by transacting with those who have a credit rating of at least investment grade when depositing surplus funds. However, in developing countries, it may be necessary to deal with banks of lower credit rating.

Derivatives are used solely for hedging purposes and not for speculation and the Group only enters into derivative transactions with counterparties which have credit ratings of at least investment grade, even in developing countries, because of the longer-term effect.

As at 31 December 2015, bank deposits of HK$2,902 million (2014: HK$2,463 million) and derivatives with notional amount of HK$1,843 million (2014: HK$1,788 million) were transacted with financial institutions with credit ratings of at least investment grade.

Long Term Fixed-to-Total Borrowings (adjusted for the hedging effect)



Share information

At market close on 16 March 2016, the Company's share price stood at HK$8.13, giving a market capitalisation of HK$12.5 billion (US$1.6 billion). This reflects a discount of 66% to net assets attributable to shareholders of the Company, or a discount of 68% to the adjusted net assets attributable to shareholders (see page 54).

The average closing price during 2015 was HK$10.03, with the highest price of HK$12.20 achieved on 7 May 2015 and the lowest price of HK$8.00 recorded on 15 December 2015.