

EXTERNAL ENVIRONMENT AND INDUSTRY TRENDS

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The Group considers a number of significant factors when reviewing our ability to create value in the short, medium and long term. In addition to our principal risks and emerging risks which are listed in the Group Risk Committee Report on pages 132 to 137, we have also identified various external factors, emerging risks and industry trends together with our key stakeholders which may impact our business. These include aspects of the macroeconomic context in which we operate, as well as environmental challenges, technological changes, terrorist threats and issues specific to the hospitality industry. In 2015, the relevant Heads of Corporate Departments updated the Board on these issues, which are discussed on the following pages. This is by no means an exhaustive list of factors which affect our business; the objective is to give our shareholders some insight into the external environment in which we operate, as per the International Integrated Reporting Framework.

Rising Interest Rates

The Group takes a robust and structured approach on Treasury management. We have a comprehensive set of Treasury policies and guidelines that are reviewed and approved by the Group Management Board and Finance Committee annually. The policies and guidelines are used to set up financial indicators to measure and manage the key financial risk exposures of the Group. The financial indicators are monitored monthly and some are disclosed in the Group financial reports. The key financial risk exposures are interest rate, liquidity, financing, foreign exchange and counterparties.

The Group is monitoring interest rate rises closely as one of the principal risks for our Group, and we take a prudent and conservative approach to managing this risk. This risk has been included in this chapter due to the potential of rising interest rates. Significant floating rate liabilities could result in higher financing costs, if and when interest rates increase. The US Federal Reserve increased interest rates

in December 2015 for the first time since the global financial crisis in 2008, and further increases are forecast in the coming year. This may have a “ripple effect” across the wider global economy. To manage the increased interest rate environment, we work with partner banks to actively manage our fixed-to-floating interest rate ratio, which is one of the financial indicators. In addition to raising funds on a fixed-rate basis, derivatives are transacted to manage our interest rate exposure. As at 31 December 2015, we had fixed rate liabilities of 62% (vs 38% floating rate liabilities) as compared to 44% in the previous year.

Liquidity and financing are other major risks. With property investments for future hotel developments in London, Yangon and Istanbul, and uncertainty in some of our key markets including our home market of Hong Kong, we need to maintain sufficient funds to meet our short and long-term obligations. We monitor current and expected cash requirements and the financial indicator “financing horizon”. This indicates the number of months the Group’s existing cash and committed facilities can cover our outstanding capex and investments, based on approved budget without any surplus operating cashflow from operations, and any refinancing. As at 31 December 2015, the Group achieved our requirements for the financial indicator financing horizon by maintaining a mix of committed facilities and cash. We also regularly explore different funding structures and options. We maintain and build strong relationships with a diverse range of banks of investment grade and above which would be able to extend credit facilities as and when required.

Terrorist Threats

HSH is expanding its global portfolio at a time of increasing security threats and terrorism attacks. The terrorist threat is truly global – in recent years, attacks have occurred in New York, Boston, Sydney, Paris, London, Ottawa, Istanbul, as well as incidents in China, Thailand, Philippines and Myanmar – many of the countries where HSH people and assets are based.

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The strategy we are adopting to mitigate this risk is to strengthen our network with security stakeholders including local intelligence agencies and police departments, and to enhance our global intelligence monitoring. We are taking steps to upgrade our global crisis management capabilities with virtual and video conferencing technology, boosted global security manpower resources in key markets and enhanced crisis training and drills for staff according to the local threats in their region. As a company with frequent staff travel, we already have global security and medical evacuation capabilities through renowned international service providers, and in addition we are increasing travel security protection and tracking for staff.

In an advisory on global terrorist threat issued in November 2015, the World Travel & Tourism Council stated: “Enhancing security is not about closing borders or tightening visa restrictions. It is about working collectively on the ground to prevent terrorism. This means having more security people in place, monitoring the sources of terrorism in a country and enhancing the processes for sharing intelligence about people crossing borders.”

HSH follows such guidelines closely when developing our risk management and security strategies.

Cybersecurity

As mentioned in the Governance section on page 106, we have strengthened our Group Management Board with the appointment of two new members, including Mr Shane Izaks, Group General Manager of Information Technology. This reflects the strategic importance the Board places on technology development and the significant investments we are making in Information Technology and cybersecurity.

Around the world from 2014 to 2015, there were 1.43 billion cyberattacks from online resources, 123 million internet viruses, and 295,000 malicious software programmes.¹ Several hotel companies were victims of cyberattacks and credit card fraud. With such a constant threat, the risk of an attack on our Company is high and we are mindful that it is almost impossible to fully prevent such attacks if a malicious party is determined to target a particular company. To mitigate this risk in 2015 we have stepped up our prevention and protection standards, enhanced our network protection, and enforced security measures such as updating antivirus and firewall protection. We also enhanced internal communication of these threats across our Group, and introduced more extensive orientation for new employees, with the objective of managing any vulnerabilities that may exist.



¹ Source: Kaspersky Security Bulletin 2014



Climate Change and Water Scarcity

Climate change is a significant challenge facing the world today and has been included in the principal risks overview on page 134. Scientists have warned that climate change impact would become catastrophic and irreversible if global temperature increases by two degrees above pre-industrial levels. As outlined in the Group's Sustainable Luxury Vision 2020, making our business more resilient to climate impact and reducing greenhouse gas emissions associated with our own business and our value chain is important. The increasing impact of climate change is evident in the cities where we operate. These cities are seeing increasing incidents of extreme weather events which pose potential risks of disrupting our business operation. In addition, climate change may also affect water availability and quality in certain regions of the world, and lead to decreased agricultural productivity, potentially limiting the availability or increasing the cost of our supplies.

In 2015, we commissioned a research study on climate science and impact to HSH's businesses. More details on this study and our approach to energy saving and mitigating climate change risk can be read on pages 42 to 44 of the Corporate Responsibility and Sustainability Report.

Extensive media coverage was achieved in December when The Peninsula New York volunteered to participate in the NYC Carbon Challenge, committing to reduce its carbon intensity by 30% by 2025, in support of the city's collaborative effort in curbing greenhouse gas emissions. The NYC Carbon Challenge reflects our Group's own Sustainable Luxury Vision 2020 in which we endeavour to support the local communities where we operate and to be conscious of our environmental footprint.



We are pleased to report that HSH was recognised once again by the Carbon Disclosure Project (CDP) Climate Disclosure Leadership Index for the region in 2015. This annual index recognises the top 10% of CDP reporting companies which demonstrated robust management and transparency in climate strategy and measurement.

Biodiversity Loss

Biodiversity is declining rapidly due to land use changes, over-exploitation, climate change, and pollution. We have a shared responsibility in using the resources provided by nature, and do what we can to protect biodiversity and ecosystems which we all rely on. At HSH, as a business with a global supply chain, we are aware that the purchasing choices we make not only affect the experience

we create for our guests, but also have a direct impact on the environment and the communities in which we operate. We are committed to taking a responsible, ethical and sustainable approach to sourcing our products. Making thoughtful choices for our guests and for the planet is central to the proposition of our Sustainable Luxury Vision 2020. More details are on page 60 to 65 of the Corporate Responsibility and Sustainability Report.

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Mobile Convenience

A significant industry trend that has emerged in the past two years is the shift towards customer preference for mobile booking, mobile check-in, and seamless connectivity across devices and platforms. We are experiencing a paradigm shift in technology where nanotechnology, virtual reality and the “Internet of Things” are becoming more commonplace. The hospitality industry is embracing the concept of smart rooms, wearable technology, and enhanced security through retina scans or i-beacons in shopping arcades. This shift towards a virtual world is both a risk factor and an opportunity; the most innovative companies will adapt to their customer preferences, but it brings significant costs in terms of financial and human capital and training. HSH is dedicated to innovation and offering seamless connectivity on the in-room technology that we have designed in-house, and we keep up with the latest trends in technology through our Research and Technology team. However, we endeavour to strike a balance between the requirements of the modern traveller and also the warm personalised service that is the hallmark of the Peninsula brand. More details about our approach to innovation and technology can be read on pages 88 to 91 and our latest digital and mobile innovations in “Our Brand” on pages 81 to 87.



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The Sharing Economy

The so-called “sharing economy”, of which Airbnb and Uber are the most famous examples, is growing from strength to strength. Technology magazine *Fast Company* speculated that Airbnb will soon become the “world’s largest hotel chain, without owning a single hotel”. However, an independent analysis conducted by STR, a company that tracks supply and demand data for the hotel industry, on Airbnb in New York showed no correlation between the company’s presence and hotel performance in Manhattan, New York.

As of 2015, HSH management believes that Airbnb is competing with three and four-star hotels rather than the ultra-luxury sector in which we operate, and is particularly targeting guests who book extended stays of more than seven days. “Sharing economy” companies are operating in uncharted legal territory and are not subject to the stringent health and safety regulations that traditional hotels are subject to, and we believe discerning guests will demand a certain level of service that unregistered accommodation cannot provide. However, we continue to monitor the fast-moving developments in the “sharing economy” and its move towards the ultra-luxury sector.

A detailed description of our Group’s approach to risk management and the ‘Three Lines of Defence’ model are described in detail on the following pages of the Corporate Governance Report pages 127 to 131.