THE HONGKONG AND SHANGHAI HOTELS, LIMITED | *Annual Report 2006*

Contents

Financial and Operating Highlights

	2006	2005	% Increase/ (Decrease)
Income statement (HK$m)			
Turnover	**3,723**	3,276	14
EBITDA	**1,281**	1,092	17
Profit before non-operating items	**904**	688	31
Profit attributable to shareholders	**2,094**	2,664	(21)
Dividends	**228**	199	15
Earnings per share (HK$)	**1.47**	1.89	(22)
Earnings per share excluding non-operating items (HK$)*	**0.54**	0.45	20
Dividends per share (HK cents)	**16**	14	14
Dividend cover (times)	**9.2x**	13.4x	(31)
Interest cover (times)	**8.2x**	5.2x	57
Weighted average gross interest rate	**5.0%**	5.0%	–
Balance sheet (HK$m)			
Total assets	**24,609**	21,972	12
Audited net assets attributable to shareholders	**16,982**	14,896	14
Adjusted net assets attributable to shareholders	**21,841**	**	N/A
Audited net assets per share (HK$)	**11.89**	10.51	13
Adjusted net assets per share (HK$)	**15.29**	**	N/A
Net borrowings	**2,076**	2,313	(10)
Gearing	**11%**	13%	(16)
Cash flow (HK$m)			
Net cash generated from operating activities	**1,164**	1,058	10
Capital expenditure	**645**	664	(3)
Net cash inflow after interest and dividends before financing activities	**232**	1,928	(88)
Share information			
Highest share price (HK$)	**13.30**	9.35	42
Lowest share price (HK$)	**8.05**	7.40	9
Year end closing share price (HK$)	**13.14**	8.50	55
Operating information			
Number of hotel rooms	**2,561**	2,564	–
Average occupancy rate***			
– Asia	**70%**	74%	(5)
– United States of America	**74%**	73%	1
Average room rate			
– Asia (HK$)	**1,605**	1,337	20
– United States of America (HK$)	**4,129**	3,722	11
RevPAR			
– Asia (HK$)	**1,120**	990	13
– United States of America (HK$)	**3,076**	2,730	13

* *Please refer to calculation on page 49.*

** *The comparative figure for adjusted net assets as at 31 December 2005 is not meaningful as no fair valuation was conducted for hotels and golf courses as at that date.*

*** *Occupancy rates are stated based on the total number of rooms at each hotel. In 2006, The Peninsula Manila was partially closed for an extensive renovation.*

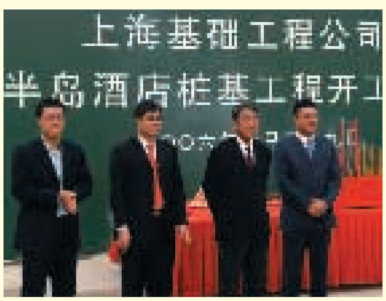
Milestones 2006

Peak Tower Renovation Completed

The Peak Tower was completely revitalised and re-opened its doors in phases starting in July. The re-design of the Tower, including the creation of the new atrium, has added an additional 1,664 square meters of lettable space. A grand opening party was held in November to celebrate its re-opening. (see pages 9-10 & 30-31)

The Peninsula Shanghai Construction Commenced

Groundbreaking for this project, which is located on the famous Bund in Shanghai, took place in October. Piling will shortly be completed and construction of the basement diaphragm walls is well underway. Hotel opening is targeted for 2009. (see pages 11 & 36)



Corporate Accolades

HSH was named by The Wall Street Journal Asia as the sixth most admired company in Hong Kong and took the bronze award for its 2005 annual report in the Hong Kong Management Association's annual competition. Chief Executive Officer Clement K. M. Kwok was named one of the Executive Directors of the Year by the Hong Kong Institute of Directors.

The Peninsula Tokyo Opening in 2007

The next addition to the Peninsula hotel family was topped out in June, and officially introduced to the media in September. The Peninsula Tokyo is situated in a prime location in the prestigious Marunouchi business district overlooking the Imperial Palace and gardens, and will open its doors in the autumn of 2007.
(see pages 10 & 34-35)

The Peninsula Beijing Renamed

After the completion of its extensive four-year renovation, our hotel in China's capital was re-named as The Peninsula Beijing in June. (see pages 24-25)

Extensive Renovation of The Peninsula Manila

In December, The Peninsula Manila completed an extensive renovation covering all the guestrooms in the Makati Tower, the Rigodon Ballroom, the Lobby and other public areas. The newly-renovated guestrooms are already achieving a significantly improved room rate as compared to the unrenovated rooms. (see pages 26-27)

New Fleet of Rolls Royce Phantoms

The world's largest fleet of 14 Rolls Royce Phantoms was delivered to The Peninsula Hong Kong in December, marking a new era in the 36-year co-operation between the hotel and Rolls Royce, which has provided guests at our flagship hotel with the most luxurious means of transportation.
(see pages 14-15)

New Peninsula Spa Concept

The Peninsula Bangkok

The Peninsula Hong Kong and The Peninsula Bangkok opened new spas in May and December respectively, thus marking the launch of the new Peninsula spa concept which has been developed in conjunction with internationally renowned spa experts, ESPA.
(see pages 14-15 & 22-23)

The Peninsula Hong Kong

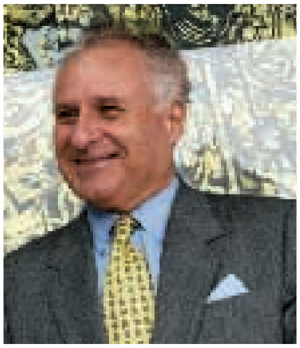
Ten Year Operating Summary

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Hotel and Property Performance										
The Peninsula Hong Kong										
Occupancy rate	**80%**	79%	69%**	57%	62%	56%	55%	50%	47%	60%
Average room rate (HK$)	**3,228**	2,872	2,659	2,337	2,670	2,749	2,984	2,834	2,776	3,472
RevPAR (HK$)	**2,592**	2,271	1,836	1,332	1,655	1,527	1,654	1,419	1,305	2,095
The Peninsula New York (closed January 1998, re-opened November 1998)										
Occupancy rate	**74%**	75%	76%	67%	65%	66%	78%	62%	34%	77%
Average room rate (HK$)	**5,458**	4,902	4,137	3,900	3,958	3,839	4,155	3,882	4,643	3,129
RevPAR (HK$)	**4,066**	3,655	3,145	2,613	2,565	2,519	3,237	2,390	1,600	2,418
The Peninsula Chicago (opened June 2001)										
Occupancy rate	**72%**	71%	72%	64%	51%	30%				
Average room rate (HK$)	**3,398**	2,947	2,490	2,437	2,338	2,371				
RevPAR (HK$)	**2,449**	2,087	1,781	1,560	1,197	719				
The Peninsula Beverly Hills										
Occupancy rate	**83%**	83%	84%	81%	78%	78%	85%	82%	81%	80%
Average room rate (HK$)	**4,523**	4,091	3,634	3,250	3,121	3,184	3,114	3,041	2,992	2,870
RevPAR (HK$)	**3,772**	3,395	3,046	2,633	2,439	2,471	2,644	2,481	2,412	2,296
The Peninsula Bangkok (opened November 1998)										
Occupancy rate	**71%**	72%	77%	66%	73%	73%	82%	32%	9%	
Average room rate (HK$)	**1,424**	1,293	1,155	1,056	986	889	572	770	1,362	
RevPAR (HK$)	**1,010**	935	893	697	718	646	468	249	119	
The Peninsula Beijing										
Occupancy rate	**67%**	66%***	58%***	49%	63%	63%	64%	59%	63%	58%
Average room rate (HK$)	**1,436**	1,219	1,008	845	691	671	719	734	809	974
RevPAR (HK$)	**958**	806	589	414	434	420	457	431	510	565
The Peninsula Manila										
Occupancy rate	**66%***	78%	69%	62%	59%	48%	54%	60%	51%	69%
Average room rate (HK$)	**737**	630	606	562	627	815	752	886	1,202	1,265
RevPAR (HK$)	**484**	493	420	349	370	390	410	533	612	873
Quail Lodge Resort, Carmel (acquired February 1997)										
Occupancy rate	**65%**	61%	54%	28%****	54%	58%	66%	64%	65%	71%
Average room rate (HK$)	**2,190**	2,297	2,288	2,214	1,871	1,962	2,062	1,869	1,961	1,856
RevPAR (HK$)	**1,431**	1,393	1,229	624	1,014	1,136	1,361	1,188	1,273	1,318

Notes:
Occupancy rates are based on the total number of rooms at each hotel. It should be noted that:
**   In 2006, on average, 133 rooms were closed for renovation at The Peninsula Manila.*
***   In 2004, on average, 31 rooms were closed for renovation at The Peninsula Hong Kong.*
**** In 2005 and 2004, on average, 41 and 30 rooms were closed for renovation respectively at The Peninsula Beijing.*
*****In 2003, on average, 37 rooms were closed for renovation at Quail Lodge Resort, Carmel.*

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Hotel and Property Performance										
The Repulse Bay apartments										
Occupancy rate	**91%**	82%	77%	74%	77%	89%	85%	76%	89%	95%
Average monthly yield per square foot (HK$)	**33**	27	25	25	29	33	31	31	42	43
The Landmark, Vietnam										
Occupancy rate – Residential	**97%**	94%	95%	94%	94%	87%	82%	84%	75%	89%
Average monthly yield per square foot (HK$)	**17**	16	16	15	15	14	14	16	20	32
Occupancy rate – Office	**99%**	95%	98%	100%	100%	98%	91%	98%	100%	99%
Average monthly yield per square foot (HK$)	**19**	17	16	16	15	15	22	33	36	39
St. John's Building										
Occupancy rate	**99%**	90%	87%	78%	83%	97%	86%	69%	67%	85%
Average monthly yield per square foot (HK$)	**21**	15	15	14	17	21	20	21	38	52
The Peak Tower										
Occupancy rate	**72%***	31%*	100%	100%	98%	100%	96%	93%	98%	100%
Average monthly yield per square foot (HK$)	**29**	6	28	23	25	24	30	36	44	54
The Peak Tram										
Patronage ('000)	**4,430**	3,923	4,107	3,092	3,714	3,504	3,478	3,277	3,312	4,159
Average fare (HK$)	**15**	14	14	14	14	14	15	14	14	12
Employee Numbers (31 December)										
Hotels	**4,601**	4,334	4,814	4,748	4,918	4,974	4,780	4,837	4,779	4,390
Property	**316**	307	297	306	315	326	334	375	402	406
Miscellaneous	**1,004**	981	955	946	984	1,072	1,263	1,398	1,380	1,619
Total employees	**5,921**	5,622	6,066	6,000	6,217	6,372	6,377	6,610	6,561	6,415

Note:
Occupancy rates are based on the total number of rooms or space available at each operation. It should be noted that:
* *Renovation of premises at The Peak Tower commenced in April 2005 and finished in phases from July 2006.*



Looking back on our 140th year of operation, I am proud of the footprint which the Company has made in the sands of Hong Kong's history. At the same time, I am mindful of what this Company stands for: qualities known and appreciated by our guests and our investors alike, which are vision, innovation, service and value.

The year 2006 has once again demonstrated the Company's innovation. In November we unveiled a fresh face for one of Hong Kong's most recognisable landmarks, the new Peak Tower, which has been completely renovated. An elevated Viewing Terrace brought a new perspective to this property while the much expanded areas were fully let at opening, reflecting healthy retailer confidence in this asset. By all accounts, the new Peak Tower has increased its popularity among both the local community and visitors who have embraced its new look.

Our initiatives have encompassed The Peninsula Beijing, which completed its re-branding exercise following a successful renovation carried out over the past few years; and the Peninsula Manila, which had a double celebration – the completion of its renovation together with its 30th anniversary. The Peninsula Manila remains as graceful as ever as she enters her fourth decade, our first Peninsula to be built overseas.

Improving our existing assets remains a key strategy in favourably positioning the Company in today's keenly competitive environment. The new Peninsula spa concept has been showcased with the openings of the spas at The Peninsula Hong Kong and The Peninsula Bangkok, which have generated a most favourable reaction from our guests. In addition, towards the end of 2006 we welcomed the arrival of 14 new Rolls Royce extended wheelbase Phantoms to The Peninsula Hong Kong, the largest order of such a fleet in the world. These improvements reflect the Company's continual commitment to providing excellent value in terms of products and services to our increasingly sophisticated guests.

We continue to make progress on our other important goals, which are to expand into key destinations through ownership together with management of select projects in prime locations. The Peninsula Tokyo, which is situated in one of the city's most prestigious locations overlooking the Imperial Palace and its gardens, is undergoing the final phase of interior fit out. The new management team is in place and we expect to open this hotel in the autumn of 2007. Our commitment to innovation will lend new expression to this property, where guests will be able to enjoy the latest exclusively-Peninsula technology throughout the premises. Meanwhile, The Peninsula Shanghai is making good progress and construction has begun.

As we move into 2007, the outlook continues to be good. Business confidence is strong in most markets where we operate, witnessed by the healthy occupancies and average room rates reported by the hotels, and high occupancies in our offices, commercial arcades and apartments. Buoyed by Hong Kong's position as Asia's financial hub and mainland China's gateway to the international financial markets, our share price has appreciated considerably during the year, reflecting healthy investor interest. Challenges are to be expected: the hotel scene in Beijing is heating up as the city gears itself for the 2008 Beijing Olympic Games; and the outlook in Thailand may continue to be uncertain after last year's political changes. We remain, however, optimistic as the Company continues with its expansion plans.

We have been fortunate in achieving excellent results through the full support of a very dedicated team. I speak for the Board when I express my gratitude to all our staff around the world, who share our heritage and vision and unfailingly give value to our loyal guests. Through their efforts, awards and accolades have come our way. It is the staff who are the real custodians and protectors of our brand integrity. They are, truly, the Peninsula Ambassadors who put the face to our name.

The Hon. Sir Michael Kadoorie
15 March 2007

Our Group has had another excellent year in 2006. Amidst favourable market conditions, our hotels and other properties and businesses benefited from their strong market positions and the strength of our brand to achieve a significant improvement in earnings, with this year's net profit before non-operating items of HK$904 million, representing an increase of 31% from last year.

HSH has now enjoyed a sustained recovery over the past five years since emerging from the Asian financial crisis which began in the late 1990s. The extent of this recovery can be seen from our EBITDA trend, which has improved consistently every year from a low of HK$698 million in 2001 to HK$1,281 million in 2006. The cumulative effect of these years of earnings growth, coupled with a number of successfully executed corporate transactions, is that the Company's financial position has been significantly strengthened, with our gearing level dropping further to 11% at this year-end.

Hotels

Although the Group has a relatively small number of hotels with a total of seven Peninsulas worldwide, it has established an enviable international brand name through the quality of its physical product and its commitment to service excellence. All the Peninsula Hotels are either top or amongst the leaders in room rate and revenue per available room ("RevPAR") in their respective cities.

We continue to focus on seeking projects to enhance our brand and our services, as well as to boost the return on our hotel assets. One of the main themes that we have been working on is to develop our own exclusive line of Peninsula spas, which we are doing in conjunction with the world-renowned spa operator, ESPA. During the year, the first spa under this new concept was launched with the opening of the magnificent Peninsula Hong Kong spa, and this has since been followed by the opening of the beautiful Peninsula Bangkok spa, which is housed in its own Thai-style building. The existing spas at The Peninsula Chicago and The Peninsula Beverly Hills have also been renovated under this overall initiative.

Another exciting development was the completion of the extensive renovation of The Peninsula Manila, which included all the guestrooms in the Makati Tower, the Lobby, the Ballroom and some back of house areas. Opened in December 2006, the newly renovated rooms are already commanding a substantial premium over the unrenovated rooms in the Ayala Tower.

A number of other improvement projects have been carried out within our hotels, including the rejuvenation of the roof garden restaurant and pool area at The Peninsula Beverly Hills, and a reconfiguration of the meeting rooms at The Peninsula Chicago. We also welcomed the arrival of the new fleet of 14 Rolls Royce Phantoms to The Peninsula Hong Kong.

In terms of business results, The Peninsula Hong Kong benefited from the buoyant conditions in Hong Kong and was able to increase its RevPAR by 14% to HK$2,592 (US$332). The Peninsula Beijing, having completed its name re-branding exercise during the year, increased its RevPAR by 19% to HK$958 (US$123). The Peninsula Manila was disrupted for significant periods during 2006 by the seven-month renovation construction programme, but its RevPAR only decreased by 2% to HK$484 (US$62).

The Peninsula Bangkok, recognised by *Travel & Leisure* magazine as the world's best business hotel, was affected by the coup which ousted the Prime Minister of Thailand in September 2006. Under these circumstances, the hotel has done well to maintain a RevPAR of HK$1,010 (US$129), up 8% from last year.

In North America, the three Peninsula hotels have enjoyed increases in average room rates in the midst of buoyant business conditions. The Peninsula New York increased its RevPAR by 11% to HK$4,066 (US$521), The Peninsula Beverly Hills by 11% to HK$3,772 (US$484) and The Peninsula Chicago by 17% to HK$2,449 (US$314). Amongst the many accolades won by these hotels during the year was recognition of The Peninsula Chicago as the Best Hotel in North America by *Condé Nast Traveler*.

Following the decision to resume direct management of Quail Lodge as from 1 April 2006, our new General Manager, Sarah Cruse, has worked closely with her revamped management team to re-energise and improve Quail Lodge's product quality and business levels. The business result of Quail, after depreciation but before interest, has improved by HK$12 million for 2006 as compared to the previous year. With a difficult set of union negotiations finally successfully concluded in January 2007, we are looking forward to further improvements in 2007.

With the growth in business levels, it has been a challenge to manage costs while maintaining and improving the level of service provided to guests. It is therefore pleasing that we have been able to control our operating costs, as a result of which the EBITDA margin on our hotel businesses has increased from 29% last year to 30% in 2006. At the same time, our hotels continued to gain recognition as being amongst the best hotels in the world with awards from *Condé Nast Traveler*, *Travel & Leisure*, *Zagat* and *Business Traveller Asia-Pacific*.

The top brand name retail arcades in The Peninsula Hong Kong and The Peninsula Beijing both continue to enjoy almost full occupancy. We have worked closely with our tenants to seek ways of enhancing their facilities and meeting their needs, such as creating some duplex store spaces in The Peninsula Hong Kong. During the year, these arcades achieved 96% occupancy at an average rent of HK$293 per square foot per month in Hong Kong, and 96% occupancy at HK$85 per square foot per month in Beijing.

Peninsula Merchandising has opened new Peninsula boutiques in Nagoya, Taipei and Hong Kong, bringing the total number of shops to 13. We also opened the first Peninsula Boutique and Café at the Siam Paragon mall in Bangkok.

Overall, the hotel division's revenue and EBITDA for the year were HK$2,950 million and HK$882 million, an increase of 11% and 15% respectively as compared to 2005.

Non-hotel Properties and Operations

The most significant achievement in our property division during the year was the completion of the extensive renovation of The Peak Tower in Hong Kong and its successful re-opening. Through a clever re-design of the interior space, we have been able to add 1,664 square meters (representing an increase of some 30%) of additional lettable space, as well as a lively new atrium and a spectacular new viewing terrace at the top of the Tower. The Peak Tower is now fully let at an average rent per square foot of approximately HK$42, as compared to the average rent of HK$28 per square foot prior to the renovation.

During the year, the market remained buoyant in Hong Kong for both residential and office lettings and this was reflected in the performance of our properties. The average occupancy and rental per square foot of the unfurnished apartments at The Repulse Bay increased to 94% at HK$34 per square foot per month, as compared to 86% at HK$28 per square foot in 2005. St. John's Building improved to an occupancy of 99% at HK$21 per square foot per month.

The Repulse Bay Commercial Arcade remained fully let at an average rental of HK$68 per square foot for the year. This complex has, over the years, provided excellent support services to the residents in The Repulse Bay, as well as being one of Hong Kong's leading wedding venues and a centre for dining and shopping in the south side of Hong Kong Island. Architecturally a replica of the famous old Repulse Bay Hotel, we are now exploring plans to renovate and increase its useable area, in order to further improve its functionality and appeal.

Hong Kong had a record year for tourism and patronage on The Peak Tram grew by 13% to 4.43 million passengers, despite the closure of The Peak Tower for more than half of the year due to its renovation.

Our other non-hotel operations, including the Thai Country Club, The Landmark office and serviced apartment complex in Vietnam and Tai Pan Laundry all performed satisfactorily. We have signed a new agreement with Cathay Pacific Airways for the management of their first and business class lounges at the Hong Kong International Airport which will help us to cater for the continuing increase in demand.

Overall, the revenue and EBITDA from non-hotel properties and operations for the year were HK$773 million and HK$399 million, an increase of 27% and 24% respectively as compared to 2005.

Development and Projects

Our business philosophy is based on the long-term ownership and management of a select number of top quality hotels and other properties. We believe that by seeking prime locations and then committing significant human and financial resources to creating exceptional hotels, value will be created for our shareholders through both operating results and long-term asset value appreciation. This strategy means that we will focus our resources on a limited number of new hotel developments at any one time, as exemplified by the current projects in Tokyo and Shanghai, which are both situated in exceptional locations. The Peninsula Tokyo is being built in the prestigious Marunouchi area in central Tokyo, with the front of the hotel offering a panoramic view over the Imperial Palace and its gardens and Hibiya Park. The Peninsula Shanghai will be the only new-build with a frontage directly onto the Bund, standing alongside the famous preserved buildings on this renowned promenade.

The Peninsula Tokyo project has reached a very exciting stage. The building was topped out in mid 2006 and the interior fit-out is now well advanced. The General Manager of the hotel is in place as is his senior management team and the first official press launch took place in September 2006. It is expected that the hotel will be handed over to the operations team this coming summer, for soft opening in the autumn and grand opening before the end of the year.

In Shanghai, we received all of the planning and construction permits in order to break ground and commenced piling works in October 2006. These piling works will be completed in March 2007 and construction of the basement diaphragm walls is underway. Designs of both the exterior building and the interior spaces are well progressed. We continue to work towards a timetable for completion of construction before the end of 2009.

Whilst our emphasis has been on management and delivery of the Tokyo and Shanghai projects, we have also continued to seek other opportunities for new hotel developments. However, we are selective in our choice of projects and expect to commit to new projects on a measured basis.

Finance and Results

It is very pleasing that the Company's net profit before non-operating items increased by 31% to HK$904 million in 2006. It should be noted that this figure is stated after total depreciation of approximately HK$246 million (2005: HK$231 million) resulting from our hotels being accounted for on a cost and depreciation basis, rather than at open market value. Regarding non-operating items, it is important to note that there was a one-off gain last year of HK$1,171 million from the sale of The Kowloon Hotel which did not recur this year. Otherwise, the increase in fair value of investment properties was HK$1,442 million compared to HK$1,089 million last year. The decrease in profit attributable to shareholders, from HK$2,664 million last year to HK$2,094 million this year, was therefore entirely attributable to the absence of the one-off gain from the sale of The Kowloon Hotel this year. The earnings per share for the year amounted to HK$1.47 (2005: HK$1.89). We have provided for shareholders' additional information a calculation of our earnings excluding non-operating items, which as set out on page 49, amounts to HK$761 million (2005: HK$641 million), representing earnings per share of HK$0.54 (2005: HK$0.45).

Our net asset value has increased significantly to HK$16,982 million (2005: HK$14,896 million), equivalent to HK$11.89 per share (2005: HK$10.51 per share). Our financial statements are prepared on the basis that our hotels are recorded at cost less depreciation and any impairment provision. It should be noted that in many cases, the current market value of these hotel properties is significantly higher than book value, and we have therefore provided an up-to-date assessment of these market values by independent valuers as at 31 December 2006, as set out in the Financial Review section of this annual report. It should also be noted that the above net asset value figure has been arrived at after making a provision of HK$2,407 million in respect of deferred taxation on the revaluation surplus on Hong Kong investment properties, which the Directors do not believe will materialise as capital gains on such properties are not taxable in Hong Kong. In the light of the above, the Directors have provided for shareholders' additional information a calculation of our adjusted net asset value, on the basis set out in the Financial Review section of this annual report, which amounts to HK$21,841 million (equivalent to HK$15.29 per share).

With the investment property revaluation and the Company's retained earnings, net borrowings had reduced to HK$2,076 million by the year-end, giving rise to a very comfortable net gearing ratio of 11% (2005: 13%).

Total capital expenditure during 2006, including investment in our new development projects in Tokyo and Shanghai, amounted to HK$645 million as compared to cash generated from operations of HK$1,271 million. Our net cash inflow for the year after payment of interest and dividends before financing activities was HK$232 million.

The Directors are recommending to shareholders a final dividend for the year of 11 cents per share. Together with the interim dividend of 5 cents per share already paid, the total dividend for the year will be 16 cents per share, an increase of 14% over last year. Shareholders will continue to have the option to receive their dividends in either scrip or cash.

Strategy and Outlook

I am delighted that, with the support of our Board and our management team, we have been able to focus on a consistent strategy over the past five years and I believe that it is this focus which has helped to generate the pleasing trend of results which the Company has achieved. Therefore, once again, I am able to report that our strategy remains largely unchanged with an emphasis on:

1. building our brand quality and image,
2. enhancing service delivery through staff training, development and empowerment,
3. focusing on prime locations, asset quality and design and build standards, and
4. enhancing the value and functionality of all space within our existing assets.

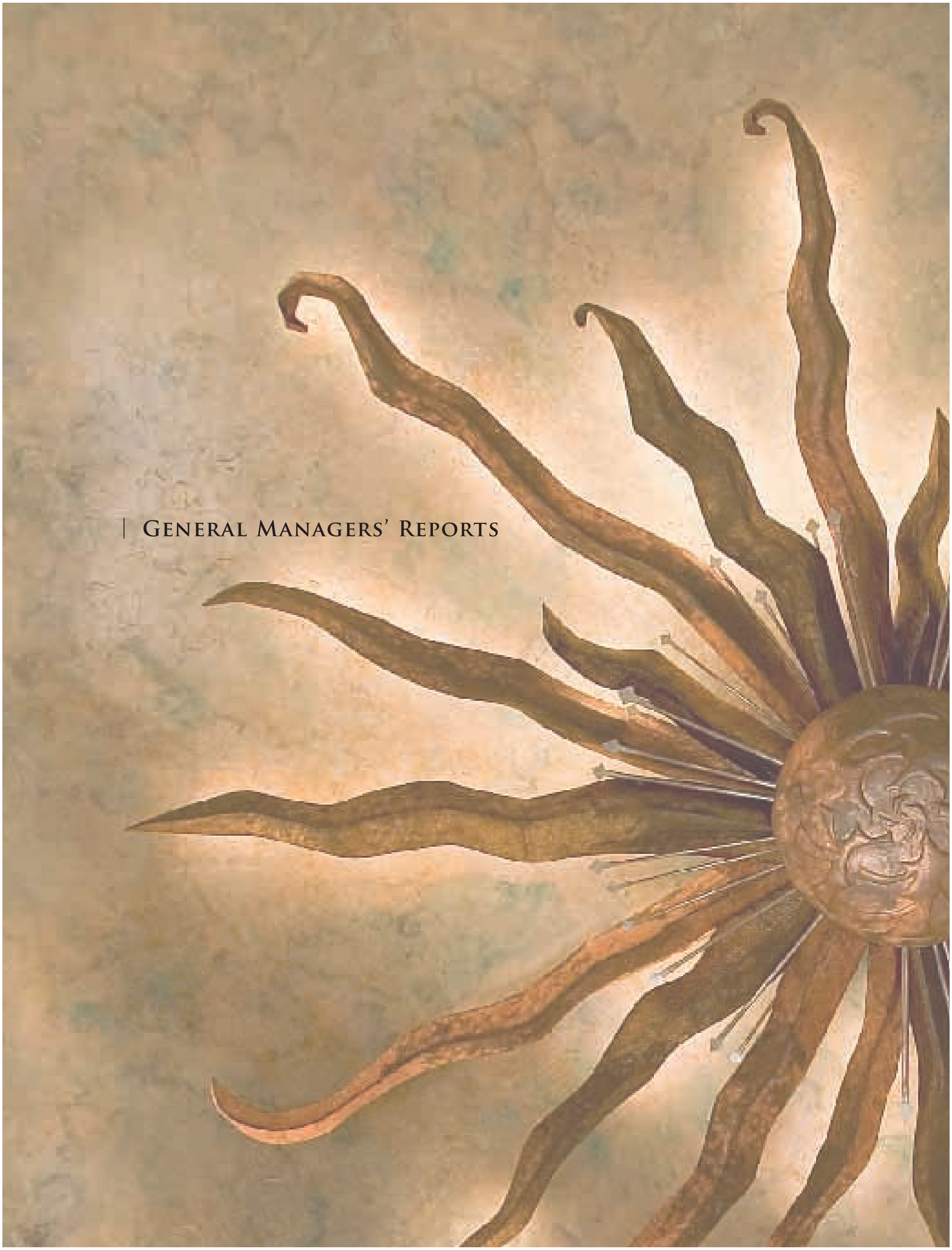
We believe that the new hotel development projects currently in progress will enhance the value of the Group in the longer term. In the meantime, we have already seen the positive effects of our ongoing renovation programme, with The Peak Tower renovation and The Peninsula Manila guestrooms renovation in particular giving rise to significant increases in revenue. The next phase of our renovation programme will see further spa developments and a revitalisation plan for The Repulse Bay Arcade.

Present business momentum is good at all of our hotels, although once again the events of the past year have served to remind us of the susceptibility of the hotel industry to unforeseen occurrences such as the military coup in Thailand. On the property side, although demand remains healthy for retail, office and residential property in Hong Kong, we may well see a slowdown in the surge in demand and the focus will be on working closely with our tenants to ensure that we can continue to offer an attractive product that meets their needs.

Ultimately, the biggest protection we have against the ups and downs of the businesses we operate in is our genuine commitment to the long term, through investing in our assets and our people and in adhering to the beliefs and values which have been proven through the long history of our Company. At the core of this is our commitment to our staff and it is fitting that I should end this message with my thanks and tribute to all the members of the Peninsula 'family' who have worked so hard, with flair as well as loyalty, to achieve the results which I am able to report this year.

Clement K. M. Kwok
15 March 2007

General Managers' Reports



Select Awards

Best Hotel Spa – SpaAsia Crystal Awards 2006
SpaAsia (Singapore)

World's Best Service – Top Hotels for Service in Asia
Travel & Leisure (USA)

No. 1 in HK and mainland China – World's Best Places to Stay Asia / Australia / Pacific Nations
Condé Nast Traveler (Jan. 2006, USA)

No. 1 in Hong Kong – Best of the Best, Preferred Brands of China's Richest
Hurun Report (PRC)

No. 1 Top Five Hotels in Asia – Reader's Choice Platinum List
Celebrated Living (USA)

The Peninsula Spa by ESPA, with sweeping views of the Victoria Harbour

Guestrooms	2006	2005	Change
Total number of rooms	300	300	–
Average occupancy	80%	79%	1%
Average room rate	HK$3,228	HK$2,872	12%
RevPAR	HK$2,592	HK$2,271	14%

Revenue (HK$m)	2006	2005	Change
Hotel	626	564	11%
Spa	12	–	–
Retail	37	35	6%
Commercial rentals	258	236	9%
Office rentals	24	23	4%
	957	858	12%

Hong Kong enjoyed a year of excellent growth as closer integration with mainland China helped fuel the economy and boosted domestic spending. The city played host to some of the world's leading trade shows and conferences, including the ITU Telecom World 2006, which provided a positive business environment and created strong business demand. Although two luxury hotels were introduced to the market, the impact was considered positive as they helped maintain healthy rates in the upper bracket. The Peninsula Hong Kong remained the city's rate leader.

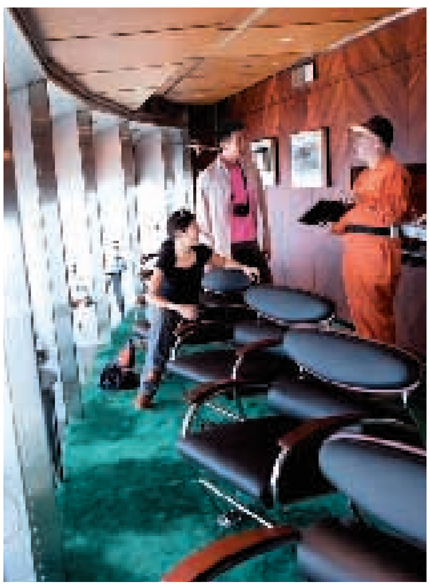
The hotel's grand lobby

THE PENINSULA HONG KONG

100% owned

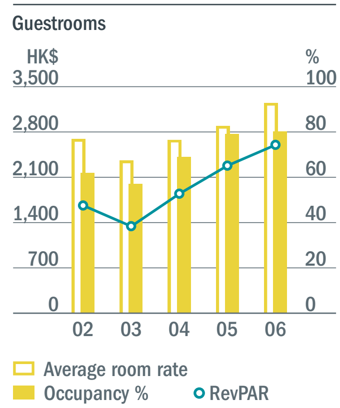
2006 saw record-breaking financial results at The Peninsula Hong Kong, with the hotel achieving its highest ever revenue in rooms, surpassing the level achieved 10 years ago. The double-digit growth of mainland visitors, the continued revival of long haul markets from North America and Europe and a significant increase of Japanese visitors brought strong business volumes to the hotel.

- The hotel achieved an ARR of HK$3,228, up 12% from 2005; RevPAR was up 14% from 2005 while occupancy increased 1% from 2005.
- The introduction of The Peninsula Spa by ESPA in May, and the Naturally Peninsula cuisine in several of the hotel's outlets in November, were both very well received. The new Spa occupies 1,116 square meters of space spread over two floors, with 14 state-of-the-art treatment rooms, a tea lounge and his and her relaxation rooms, most of which offer a sweeping view of Victoria Harbour.



The China Clipper aviation lounge

- The hotel took delivery of 14 extended wheelbase Rolls Royce Phantoms in December. Finished in signature Peninsula green, each car was handmade in England and customised under Rolls Royce's Bespoke programme to meet the hotel's exacting needs.
- Major facility enhancements include progression of the hotel property management system from Fidelio to Opera; installation of Wifi in guestrooms in both the Main Building and Tower; and modification of guestroom headboards in the Main Building.
- Reflecting buoyant retail spending, The Peninsula Arcade achieved 96% occupancy for the year. Rents continued to rise due to a shortage of outstanding retail space in the district. The hotel is favoured by international fashion and jewellery brands and the trade mix at the hotel's Arcade has been further enhanced with the arrival of some additional international brands.



Sources of guests	2006	2005
USA & Canada	33%	32%
Japan	17%	16%
Asia	16%	17%
Europe	22%	21%
Others	8%	10%
China	4%	4%
FIT	13%	20%
Corporate	22%	23%
Wholesale	42%	40%
Others	23%	17%

The Peninsula New York

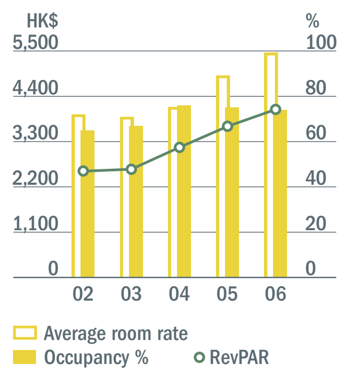
100% owned

With robust market conditions coupled with its prime location and high service standards, The Peninsula New York was able to grow its average rate strongly during the year and continues to be one of the rate and RevPAR leaders in Manhattan.

- The hotel achieved an ARR of HK$5,458, up 11% from 2005; RevPAR was up 11% from 2005 while occupancy decreased by 1%.
- Major facility enhancements during the year included replacing carpets in 53 guestrooms and replacing 15 air handling unit motors to high efficiency units.

High tea at Gotham Lounge

- Radio communication was introduced between all front of house departments to facilitate higher guest recognition and better guest satisfaction.
- Wireless internet upgrading was completed in all the guestrooms.
- Major marketing initiatives included the continual joint promotion with American Express Platinum and Centurion cardholders, which resulted in over US$2 million revenue for each category of cardholder; 'Silver Spoon Service' for guests travelling with children; a guest recognition programme with French jeweller Van Cleef & Arpels; and 'The Peninsula Wardrobe' which offers guests exclusive access to high-end clothing rental services.



Sources of guests	2006	2005
USA & Canada	66%	68%
Japan	2%	2%
Asia	3%	3%
Europe	20%	21%
Others	9%	6%
FIT	93%	78%
Corporate	7%	21%
Wholesale	–	1%

- The hotel's vitrines were popular showcases for high-end retailers including LVMH, Wempe, Sergio Rossi and Van Cleef & Arpels.

Select Awards

AAA Five Diamond Award

No.3 The Best Hotels in New York
Condé Nast Traveler (USA)

Three Stars – Fives, 2006 All-Star Eateries in New York
Forbes Magazine (USA)

The Lobby and staircase

Guestrooms	2006	2005	Change
Total number of rooms	239	239	–
Average occupancy	74%	75%	(1%)
Average room rate	HK$5,458	HK$4,902	11%
RevPAR	HK$4,066	HK$3,655	11%

Revenue (HK$m)	2006	2005	Change
Hotel	461	419	10%
Spa	43	46	(7%)
Commercial rentals	31	29	7%
	535	494	8%

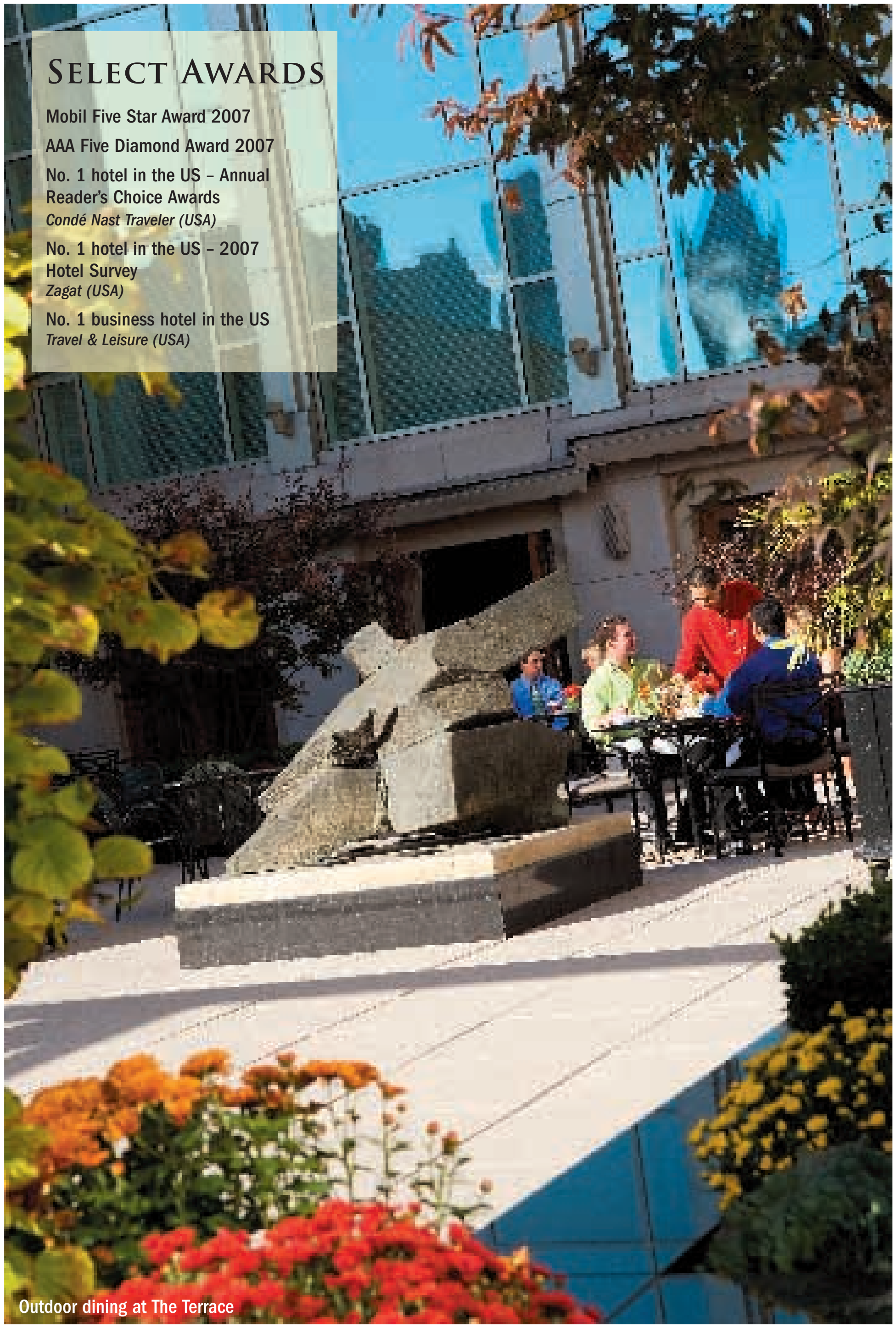
New York City enjoyed a buoyant year, with a high level of financial markets and trading activities, as well as a strong influx of foreign travellers. Demand was very strong for the top luxury hotels in Manhattan, in addition to which the supply of rooms was affected by the closure for renovation or conversion of several luxury hotels.

A pageboy at The Peninsula New York

Home to 30 Fortune 500 companies and 12 Fortune Global 500 companies, Chicago continued to prosper economically in 2006. With a large drive-in audience of 1.8 million businesses and 58 million people located within the radius of a day's drive, Chicago continued to develop infrastructure, major highways, airports,


The Peninsula Suite

the convention centre and key attractions to keep the city at the forefront of leisure and corporate business. 2006 also saw one of the best convention years in Chicago with 21 citywide conventions.



Select Awards

Mobil Five Star Award 2007

AAA Five Diamond Award 2007

No. 1 hotel in the US – Annual Reader's Choice Awards
Condé Nast Traveler (USA)

No. 1 hotel in the US – 2007 Hotel Survey
Zagat (USA)

No. 1 business hotel in the US
Travel & Leisure (USA)

Outdoor dining at The Terrace

Guestrooms	2006	2005	Change
Total number of rooms	339	339	–
Average occupancy	72%	71%	1%
Average room rate	HK$3,398	HK$2,947	15%
RevPAR	HK$2,449	HK$2,087	17%

Revenue (HK$m)	2006	2005	Change
Hotel	509	442	15%
Spa	29	29	–
	538	471	14%

The Peninsula Chicago

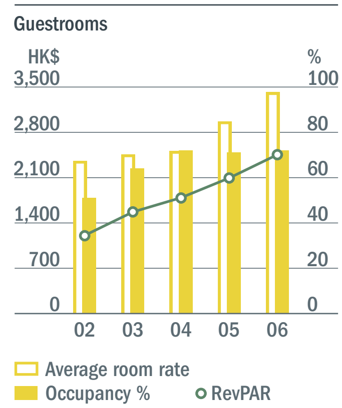
92.5% owned

The Peninsula Chicago has clearly established itself as the top luxury hotel in Chicago, retaining its leadership in average room rate in the city and placing the hotel ahead of its competitive set (source: Star Report). With continued investment in the product, exceptional service and strong brand recognition, the hotel seeks to maintain its leading position in Chicago.

- The hotel achieved an ARR of HK$3,398, up 15% from 2005; RevPAR was up 17% from 2005 while occupancy increased 1% from 2005.
- The Spa was renovated with newly added features including a relaxation room with fireplace and two new treatment suites.

The rooftop pool, with views of the cityscape

- Signature restaurants were enhanced with a renovation at Avenues, new flooring and carpet at the Bar, and Shanghai Terrace receiving an updated entrance.
- A new Business Centre was completed.
- Existing meeting rooms were given a facelift with new carpeting, wall covering, window treatments and contemporary artwork. A new meeting room was added to cater to the expanding meetings and convention business.
- Special marketing initiatives included 'Broadway in Chicago' which offered premium seats to top tier Broadway shows; and continuation of the joint promotion with American Express Platinum and Centurion cardholders.



Sources of guests	2006	2005
USA & Canada	89%	89%
Asia	1%	1%
Europe	5%	5%
Others	5%	5%
FIT	13%	10%
Corporate	27%	30%
Wholesale	26%	30%
Others	34%	30%

The Peninsula Beverly Hills

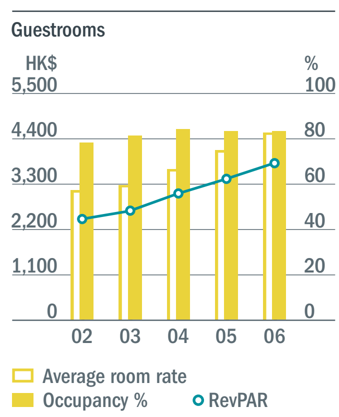
20% owned

Having already sustained an optimal occupancy of over 80% for a number of years, The Peninsula Beverly Hills' strategic focus was to grow rate, thus driving RevPAR, while maintaining its brand image and garnering new awards and recognitions.

- The hotel achieved an ARR of HK$4,523, up 11% from 2005; RevPAR was up 11% from 2005 while occupancy was the same as in 2005.
- The hotel completed its soft goods renovation of the Deluxe, California and Superior Suites in addition to rejuvenating the Roof Garden restaurant and pool area to enhance guests' experience.
- The renovation of the spa enabled the hotel to be positioned as a favourable destination for out-of-town visitors, as well as a new attraction for the local community.

A villa at The Peninsula Beverly Hills

- A cutting-edge room assignment system was introduced in the Housekeeping Department and a seamless arrival and departure process was established. The resulting gains in productivity allowed the hotel to build further on its unique, 24-hour flexible check-in/check-out capability.



Sources of guests	2006	2005
USA & Canada	85%	86%
Japan	1%	1%
Asia	2%	2%
Europe	7%	7%
Others	5%	4%
FIT	94%	92%
Corporate	1%	3%
Wholesale	5%	5%

SELECT AWARDS

Mobil Five Star Award

AAA Five Diamond Award

AAA Five Diamond Award – The Belvedere Restaurant

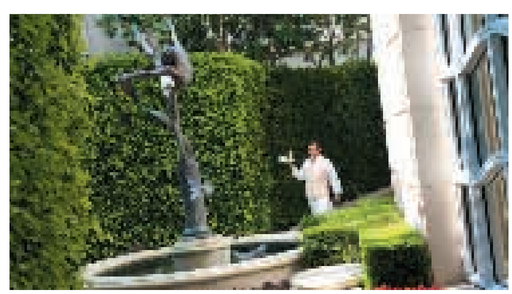
No. 1 Top 20 US City Hotels – World's Best Hotels, Resorts & Hideaways
Andrew Harper's Hideaway Report (USA)

The Living Room

Guestrooms	2006	2005	Change
Total number of rooms	194	196	(1%)
Average occupancy	83%	83%	–
Average room rate	HK$4,523	HK$4,091	11%
RevPAR	HK$3,772	HK$3,395	11%

Revenue (HK$m)	2006	2005	Change
Hotel	413	374	10%

The Californian economy continued to benefit from steady growth in the stock market and a stable political climate. This has translated into very sound occupancy and healthy rate growth for The Peninsula Beverly Hills. The positive business climate was further supported by new cultural activities and interests in Los Angeles, such as the Walt Disney Concert Hall, the Getty Villa and the recently renovated Griffith Park Observatory.



Lush gardens at the hotel

Select Awards

No. 1 World's Best Business Hotel Overall
Travel & Leisure (USA)

No. 3 Best Asian Hotel – Reader's Choice Awards 2006
Condé Nast Traveler (USA)

No. 3 World's Best Hotel – Asia
Travel & Leisure (USA)

No. 4 World's Best Hotel Overall
Travel & Leisure (USA)

Lantern Corridor at The Peninsula Spa by ESPA, housed in its own Thai-style building

Guestrooms	2006	2005	Change
Total number of rooms	370	370	–
Average occupancy	71%	72%	(1%)
Average room rate	HK$1,424	HK$1,293	10%
RevPAR	HK$1,010	HK$935	8%

Revenue (HK$m)	2006	2005	Change
Hotel	214	200	7%
Spa	2	1	100%
Retail	4	3	33%
Commercial rentals	2	2	–
	222	206	8%

2006 was a challenging year for Thailand. After a strong first half year that was underpinned by solid growth from regional and international arrivals, demand slowed dramatically in September due to political uncertainty in the country following the coup which resulted in the overthrow of the Prime Minister. The uncertainty was further exacerbated by the bombings on New Year's Eve.

Views from the Grand Deluxe Room

The Peninsula Bangkok

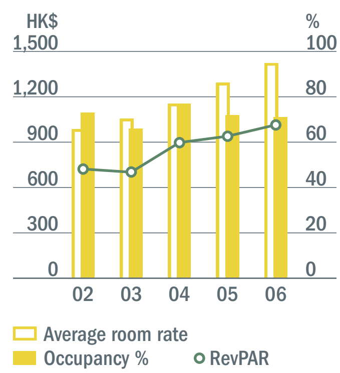
75% owned

Despite external factors impacting overall market growth, The Peninsula Bangkok achieved year-on-year revenue growth across the entire complex. 2006 also saw the hotel successfully launching its new Spa, and winning many international awards and accolades.

- The hotel achieved an ARR of HK$1,424, up 10% from 2005; RevPAR was up 8% from 2005 while occupancy fell 1% from 2005.
- New developments included the completion and opening of The Peninsula Spa by ESPA in December, to wide acclaim from guests; and the development of a new Peninsula Boutique and Café in March at Siam Paragon, the city's new shopping and entertainment complex.

Thai dessert – making class at Thiptara

- The gym and locker room area was renovated while wireless internet was installed for all the guestrooms, function rooms and pool area.
- To add flexibility to daily room assignments, 15 sets of connecting rooms were added and 11 twin-bedded suites were converted.
- An F & B concierge was introduced with the task of providing restaurant information to guests and to co-ordinate guest information.
- The retail spaces were fully occupied throughout the year.
- The hotel participated in a contest conducted by The Ministry of Welfare and Labour Protection of the Thai government, and won The Best Consultant to Female Employee Award.



Sources of guests	2006	2005
USA & Canada	22%	21%
Japan	11%	11%
Asia	28%	29%
Europe	26%	26%
Others	13%	13%
FIT	23%	25%
Corporate	25%	26%
Wholesale	47%	44%
Others	5%	5%

Select Awards

Highest rated hotel in mainland China, Gold List – World's Best 700 Places to Stay
Condé Nast Traveler (USA)

Top 50 in Asia – T & L 500 The Greatest Hotels in the World
Travel & Leisure (USA)

Top 20 Overseas Leisure Hotels – Asia and Indian Subcontinent
Condé Nast Traveller (UK)

Exterior view of The Peninsula Beijing

Guestrooms	2006	2005	Change
Total number of rooms	525	525	–
Average occupancy	67%	66%*	2%
Average room rate	HK$1,436	HK$1,219	18%
RevPAR	HK$958	HK$806	19%

* In 2005, on average 41 rooms were closed for renovation.

Revenue (HK$m)	2006	2005	Change
Hotel	319	269	19%
Commercial rentals	90	84	7%
	409	353	16%

Beijing is developing at a rapid pace which has quickened with the 2008 Olympic Games becoming more imminent. Many major international hotel companies are focused on establishing a presence in Beijing. 2006 also saw many internationally-significant events held in the city, with frequent visits by heads of states from around the world. The Peninsula Beijing, with an enviable location in the historic city centre, is competitively favoured by both leisure and corporate travellers.

The Lobby

The Peninsula Beijing

42% owned

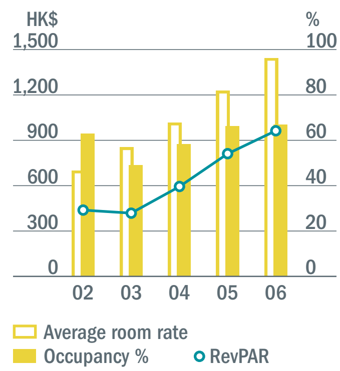
Reflecting significant investment in the hotel's facilities, the hotel was re-named as The Peninsula Beijing in July (formerly named The Peninsula Palace Beijing). The hotel's Chinese name was also changed to allow closer identification with the Peninsula Group.

- In 2006, the hotel achieved an ARR of HK$1,436, up 18% from 2005; RevPAR was up 19% from 2005 while occupancy increased 1% from 2005.
- The new Peninsula Suite has been the residence of choice for many heads of states, business leaders and high-end leisure travellers who visited Beijing.

The Peninsula Suite

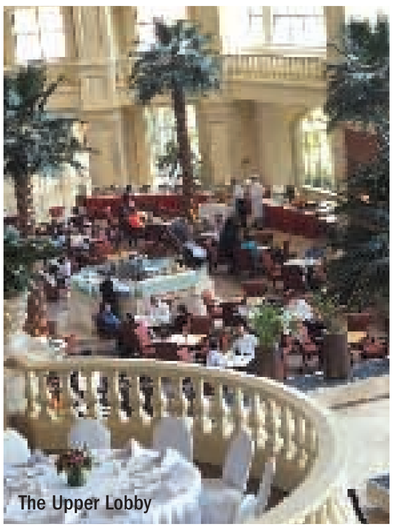
- The Peninsula Arcade remained the capital's most prestigious venue for luxury goods and continued to refine its brand mix in order to maintain its position. With 50 brands represented, it is considered to be the leading shopping arcade of its kind in mainland China.
- While the hotel saw strong overseas visitor arrivals, the domestic market is increasingly displaying substantial signs of growth.

Guestrooms



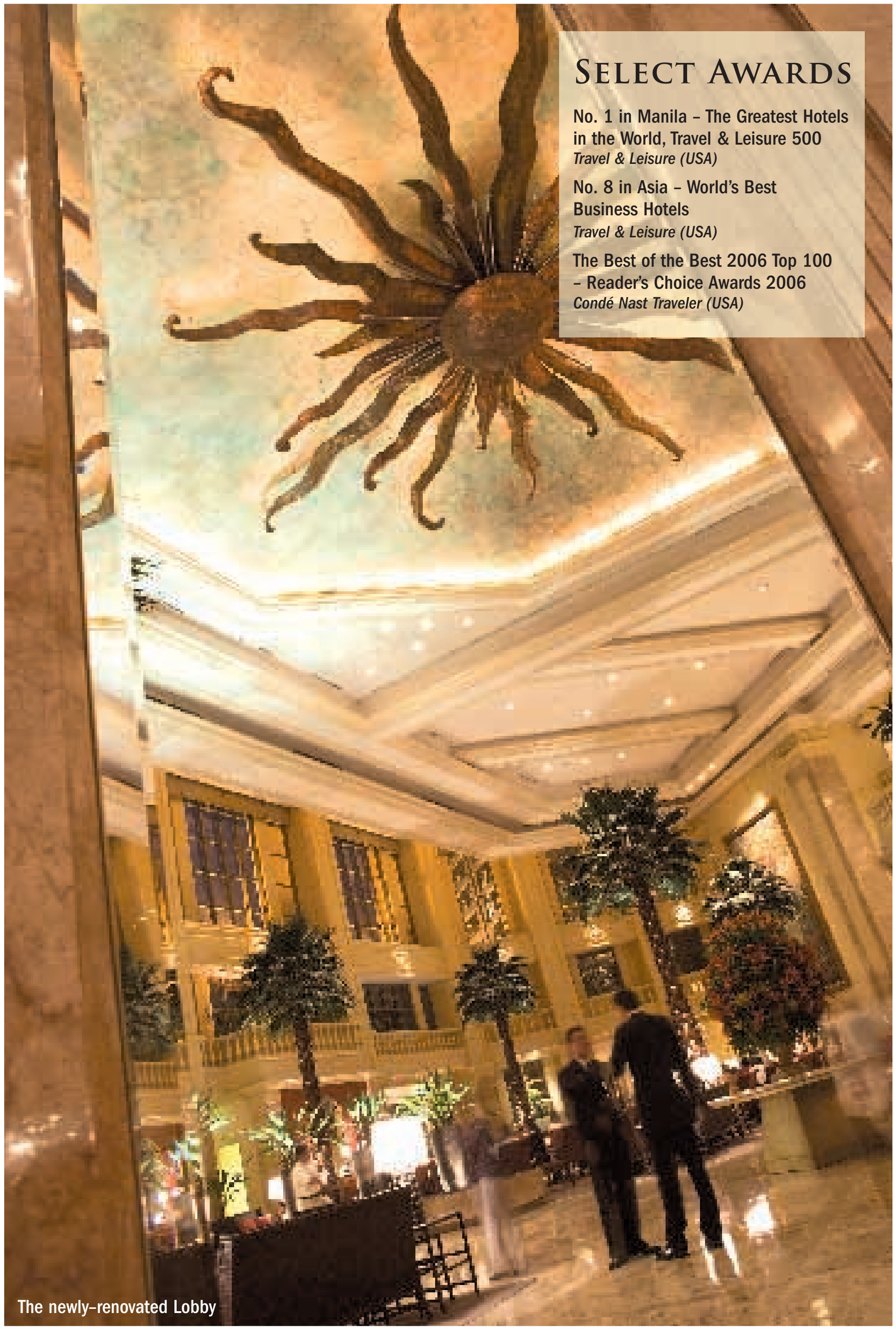
Sources of guests	2006	2005
USA & Canada	30%	25%
Japan	7%	10%
Asia	36%	40%
Europe	18%	15%
Others	9%	10%
FIT	30%	41%
Corporate	20%	17%
Wholesale	29%	23%
Others	21%	19%

The Philippines enjoyed a second year of relative political stability, although the national elections set to be held in May 2007 could lead to some political volatility. Hotel occupancy rates continued to improve, and with the absence of any additional inventory in the market, the hotel is looking forward to maximizing room



The Upper Lobby

revenues from the newly renovated Makati Tower guestrooms. The continued development in the country of call centres and back office operations is also expected to positively impact the hotel.



Select Awards

No. 1 in Manila – The Greatest Hotels in the World, Travel & Leisure 500
Travel & Leisure (USA)

No. 8 in Asia – World's Best Business Hotels
Travel & Leisure (USA)

The Best of the Best 2006 Top 100 – Reader's Choice Awards 2006
Condé Nast Traveler (USA)

The newly-renovated Lobby

Guestrooms	2006	2005	Change
Total number of rooms	497	498	–
Average occupancy	66%*	78%	(15%)
Average room rate	HK$737	HK$630	17%
RevPAR	HK$484	HK$493	(2%)

* In 2006, on average 133 rooms were closed for renovation.

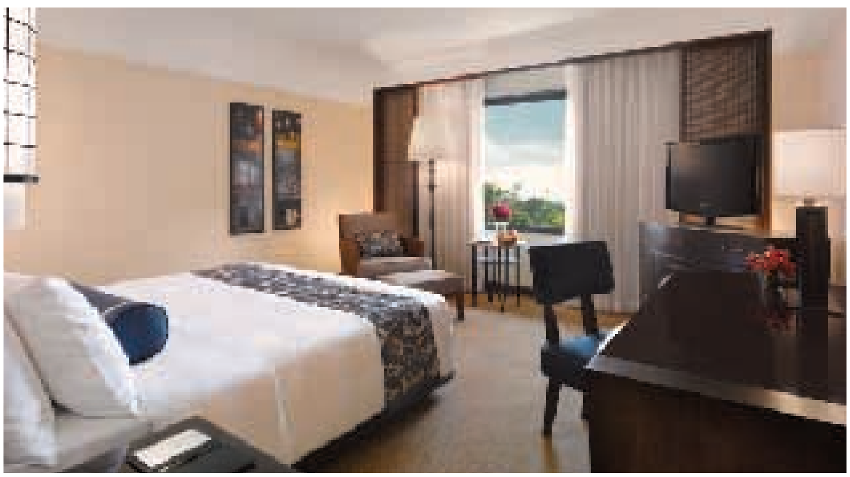
Revenue (HK$m)	2006	2005	Change
Hotel	165	168	(2%)
Spa	1	2	(50%)
Retail	5	5	–
Commercial rentals	2	1	100%
	173	176	(2%)

The Peninsula Manila

76% owned

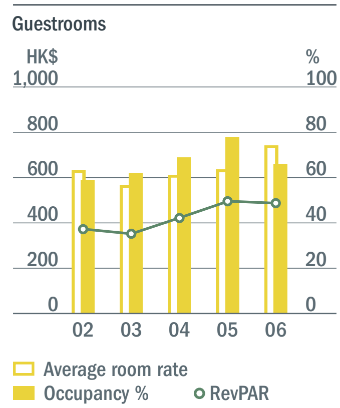
In 2006 The Peninsula Manila completed its renovation programme, encompassing the Makati Tower guestrooms, the Rigodon ballroom, function rooms and the Lobby. This successful renovation has been warmly received by both the local community and by overseas visitors.

- The hotel achieved an ARR of HK$737 in ADR, up 17% from 2005; RevPAR was down 2% from 2005 while occupancy decreased 12% from 2005. It should be noted that the average number of rooms available in 2006 was reduced due to renovation during part of the year.
- Besides the public areas and the Makati Tower, the Club Lounge, Makati Tower guest lifts, Front Office and Concierge desk were also renovated. A second boardroom was added.



A new guestroom at The Makati Tower

- A new fleet of eight Peninsula-green Mercedes Benz S-Class limousines was introduced to coincide with the renovation completion.
- A direct result of the renovation has been the marked improvement in the occupancy levels of the hotel's retail space, with an increase to 70% by the end of 2006.
- The hotel celebrated the launch of its new look in a ceremony which also marked the property's 30th anniversary.



Sources of guests	2006	2005
USA & Canada	32%	27%
Japan	10%	10%
Asia	36%	42%
Europe	10%	10%
Others	12%	11%
FIT	17%	19%
Corporate	77%	74%
Wholesale	6%	7%

- As a bid to capture the spirit of the country, the hotel launched The Peninsula Manila Digital Photographic Competition in March for photography professionals and amateurs. The winning works now adorn the walls of the new Makati Tower guestrooms.

Quail Lodge Resort And Golf Club

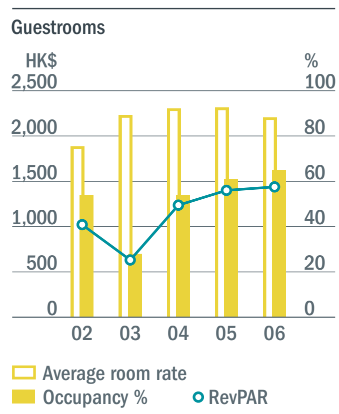
100% owned

HSH took over management of Quail Lodge Resort and Golf Club on 1 April, 2006. The management proceeded to re-structure the business and marketing plans in order to re-position the asset and increase yields. By the year-end, these changes had resulted in a significant improvement in Quail Lodge's financial results.

- Quail Lodge achieved an ARR of HK$2,190, down 5% from 2005. RevPAR was up 3% from 2005 while occupancy increased 4% from 2005.
- Major facility upgrades during the year included the lease of new greens keeping equipment; creating space for an employee dining room to improve staff welfare; and re-allocating offices to improve productivity and coordination.

Spa at the Quail Lodge

- The annual Quail Motorsports Gathering in August has been established as one of the major attractions during the classic car week and a notable event in the annual classic car agenda.
- Staffing at Quail Lodge underwent a restructuring in 2006 to streamline operations and enhance productivity. In addition, union negotiations for new contracts were successfully concluded in January 2007.
- A pet-friendly programme was re-instated and completed with a pet amenity programme.



Sources of guests	2006	2005
USA & Canada	95%	96%
Asia	1%	1%
Europe	1%	2%
Others	3%	1%
FIT	51%	52%
Corporate	49%	48%

Select Awards

AAA Four Diamond Award

The Covey Best Award of Excellence
Wine Spectator (USA)

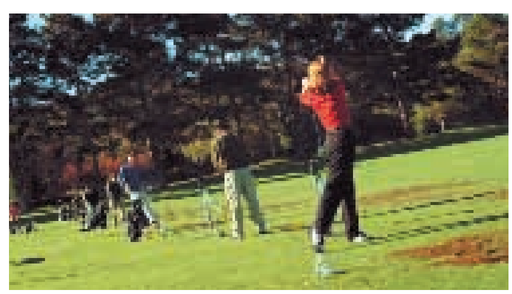
Distinguished Restaurants of North America Award
Covey (USA)

The Covey Restaurant, overlooking the picturesque lake

Guestrooms	2006	2005	Change
Total number of rooms	97	97	–
Average occupancy	65%	61%	7%
Average room rate	HK$2,190	HK$2,297	(5%)
RevPAR	HK$1,431	HK$1,393	3%

Revenue (HK$m)	2006	2005	Change
Hotel	97	89	9%
Golf club	30	31	(3%)
	127	120	6%

General business conditions in the Monterey Peninsula, particularly Carmel, were favourable in 2006. With no new additional golf courses or hotels being introduced into the market, many hotels and resorts enjoyed increased sales.



Golfing at Quail Lodge

Properties, Clubs And Other Operations

The Peak Tower's Grand Opening celebrations

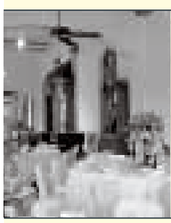
Exterior view of the new Peak Tower

Properties

The Peak Complex (Hong Kong)

- The revitalisation of The Peak Tower was completed in July 2006 and a Grand Opening celebration was held in November.
- The new look Tower was fully leased by the year end. Noteworthy features include several upscale restaurants with spectacular views over Hong Kong, a 'festival market' shopping arcade featuring contemporary interpretations of traditional and well known Hong Kong landmarks and a new elevated Viewing Terrace which offers 360-degree panaromas of the city. Since its unveiling, the Tower has been well received by the local community and overseas visitors. A positive rental growth has been achieved with average rents up by 50% and an increase in lettable space by approximately 1,664 square meters.


De Ricou serviced apartments at The Repulse Bay



The Repulse Bay Complex	2006	2005	Change
Unfurnished apartments	353	353	–
Average occupancy	94%	86%	9%
Average rental (pnsf)	HK$34	HK$28	21%
Serviced apartments	68	68	–
Average occupancy	67%	60%	12%
Average rental (pnsf)	HK$26	HK$21	24%

Revenue (HK$m)	2006	2005	Change
Residential	344	284	21%
Club	14	13	8%
Commercial rentals	37	36	3%
Food & beverage	48	42	14%
	443	375	18%

- The Peak Tram continued to perform well and achieved a record-breaking annual patronage of 4.43 million, up 13% from 2005. Revenue was very strong despite the extensive revitalisation work undertaken at The Peak Tower during the first half of 2006.
- St. John's Building was fully occupied from March onwards, with a positive increase in overall revenues and unit rates. The office leasing market on Hong Kong Island remained relatively strong overall with some areas, such as core Central, showing significant growth.

The Repulse Bay Complex (Hong Kong)

- Leasing activities for both serviced and unfurnished apartments were strong in 2006, generally a result of a steady influx of expatriates due to a buoyant economy, especially from the financial services sector.
- We had an opportunity to increase rents in line with market trends, as the supply of new luxury residential units and existing developments, particularly on the south side of Hong Kong Island, remained limited.
- A further two serviced apartments in de Ricou underwent soft goods refurbishment, bringing the number of refurbished units to 57, out of a total of 68 available apartments. The outlook for this business segment remains promising although the business pattern remains more transient, causing more fluctuation in occupancies.
- There was a high level of usage of Club facilities as a result of the high occupancies in the serviced and unfurnished apartments.
- The commercial arcade was fully let throughout the year, and the restaurants achieved stellar performance, driven by an exceptionally high level of banqueting business, particularly in the wedding segment.


The Thai Country Club

The Landmark (Vietnam)

- The Landmark continued to achieve higher rental rates and consistently high occupancies for both the residential and commercial areas.
- With the continuous upgrading of the apartments, commercial space and facilities, The Landmark has maintained its competitive edge in the market.
- Overall outlook remains positive due to limited supply of new residential and commercial buildings, and a surge of foreign direct investments following Vietnam joining the World Trade Organisation.


The Thai Country Club

Revenue (HK$m)	2006	2005	Change
St. John's Building	23	18	28%
The Peak Tower*	29	7	314%
The Landmark			
Office	19	18	6%
Residential	12	11	9%
	83	54	54%

* Renovation at The Peak Tower commenced in April 2005 and finished in phases from July 2006.

Clubs & Club Management

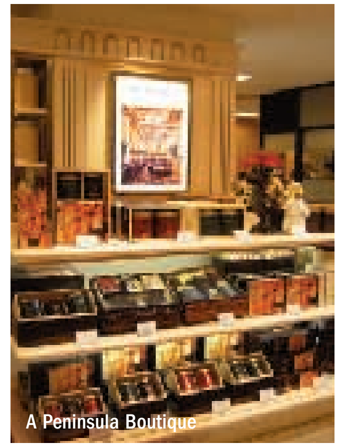
- The Thai Country Club, celebrating its 10th anniversary, was voted the Best Clubhouse in Asia and the Best Course in Thailand in the 2006 Asian Golf Monthly

Awards. It continued hosting the season-ending Volvo Masters of Asia in December. The Club remained a popular choice for golfers, resulting in improved revenues and profitability.

- Major facility enhancements included a new freshwater reservoir, an extension to the driving range to 280 yards, new sand in 12 fairway bunkers, new carpeting and flooring in major public areas.
- The Group entered into the 10th year of management of Butterfield's as it celebrated its 10th anniversary in January while The Hong Kong Bankers Club celebrated its 25th anniversary in March.
- The Wing and The Pier, both Cathay Pacific Lounges operated by the Group, won two Skytrax Awards in 2006 (No. 1 for the Best First Class Lounge, and No. 2 for the Best Business Class Lounge).

Revenue (HK$m)	2006	2005	Change
Thai Country Club	52	41	27%
PCCS	52	6	767%
	104	47	121%


The Wing, Cathay Pacific Airways' lounge at the Hong Kong International Airport


A Peninsula Boutique

Other Operations

- Tai Pan Laundry services were in good demand in 2006 given the excellent hotel occupancies.
- In 2006 Peninsula Merchandising opened its fourth licenced shop in Japan (Nagoya) and its second licenced shop in Taiwan (Taipei), bringing the total number of shops to 13. Furthermore, an agreement was signed in December 2006 to open five shops in South Korea within five years from 2007.
- The first cookbook, titled *Naturally Peninsula – Flavours*, received the 2006 Gourmand World Cookbook Award for 'Best Photography' in the 'English Rest of the World' category.

Revenue (HK$m)	2006	2005	Change
The Peak Tram	66	58	14%
Tai Pan Laundry	20	25	(20%)
Peninsula Merchandising	27	17	59%
	113	100	13%

Projects

The Peninsula Tokyo

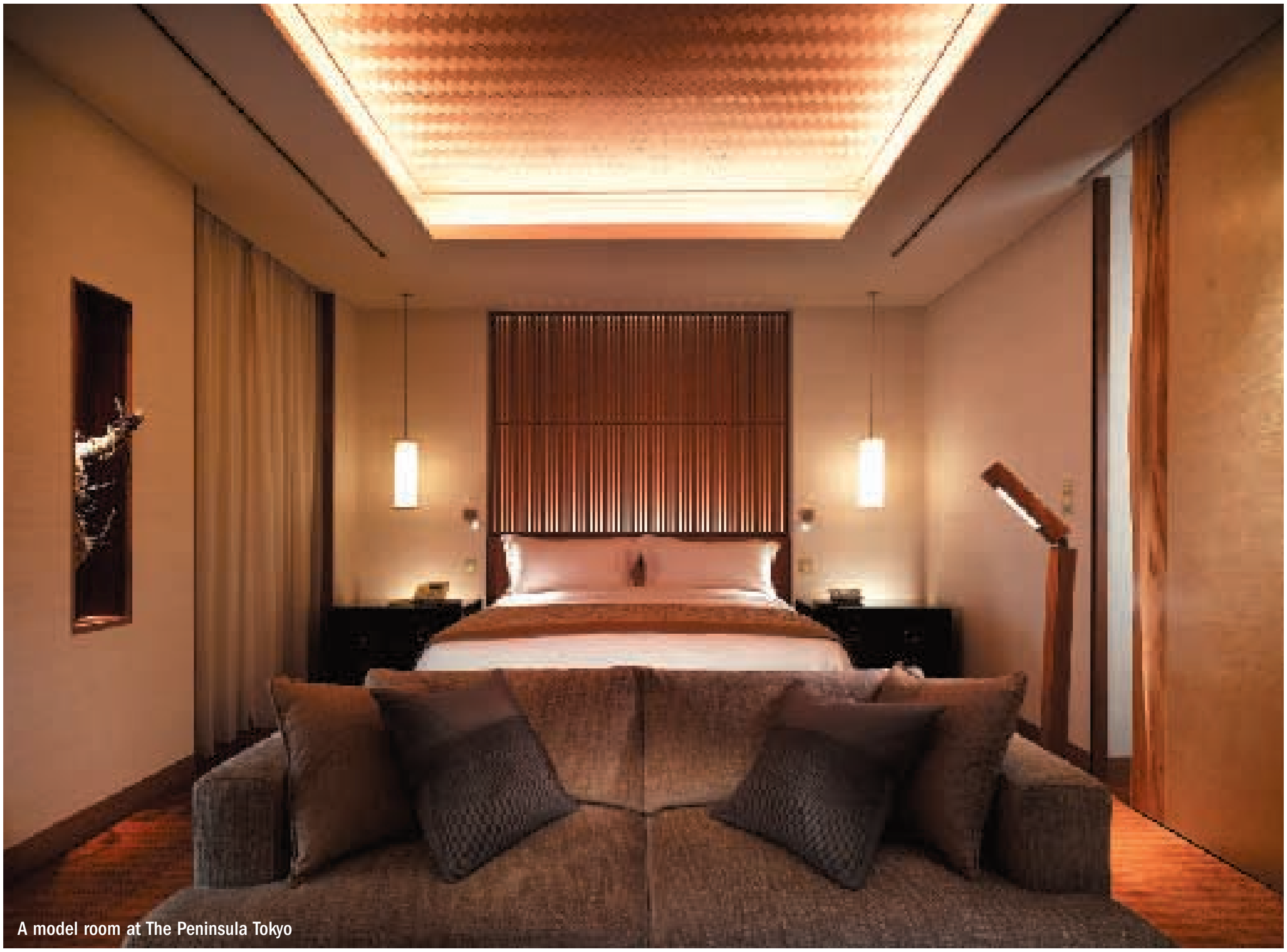
After nearly two years of construction, the building was topped off in June 2006 with the placement of the last construction beam. Work has continued apace on both the exterior and interior of the building.

Exterior view of
The Peninsula Tokyo

On the exterior, the stone façade has been installed while window glazing and bronze finishing details along the side facades has been nearly completed. Internally, wall construction and preparation of maintenance and engineering works were implemented in different stages and floor levels, and the building received electrical power. This meant that permanent equipment and systems could then be installed and the building could be operated and tested with stable electrical power. Cable installations are currently being completed at ceiling levels so that the ceilings can be enclosed, marking another step towards the construction finishing process.

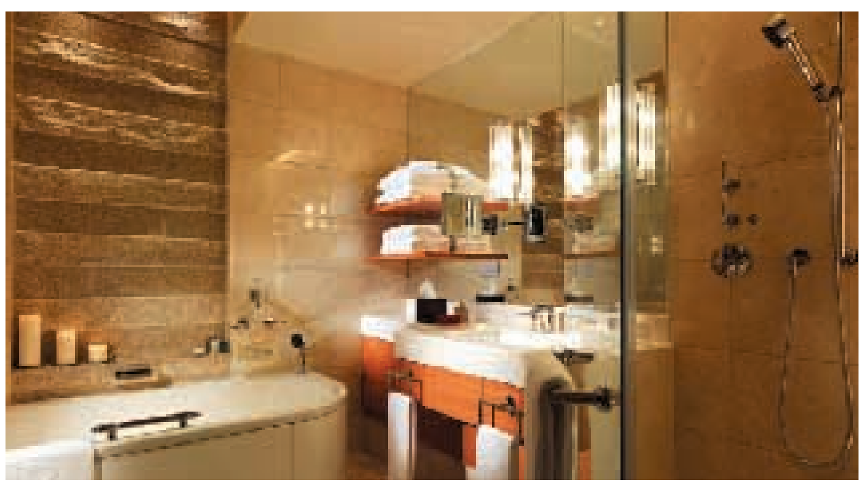
At the same time, the mock up guestrooms underwent a series of reviews, each with the aim to improve workmanship and quality of the design, materials, and finishes. By the year end, the interior fit out had begun. Emphasis has been placed on items that will receive public attention to ensure that the quality, endurance and cost are compliant with both code requirements and the design intent. Such care is constantly exercised to reflect the highest standard and quality for which a Peninsula product is known worldwide.

The Peninsula Tokyo was officially introduced to the media in September. The hotel is located in the Marunouchi district, opposite the Imperial Palace and Hibiya Park and adjacent to Ginza. It will open in the autumn of 2007 and the 24-storey structure will encompass 314 guest rooms, two ballrooms, six meeting rooms, five restaurants, a spa, an aviation lounge, bridal centre and retail space. The latest estimate of the Company’s total investment is Yen 16 billion.



A model room at The Peninsula Tokyo

The Peninsula Tokyo is located in the Marunouchi district, opposite the Imperial Palace and Hibiya Park and adjacent to Ginza. It will open in the autumn of 2007.



Bathroom at The Peninsula Tokyo

The Peninsula Shanghai

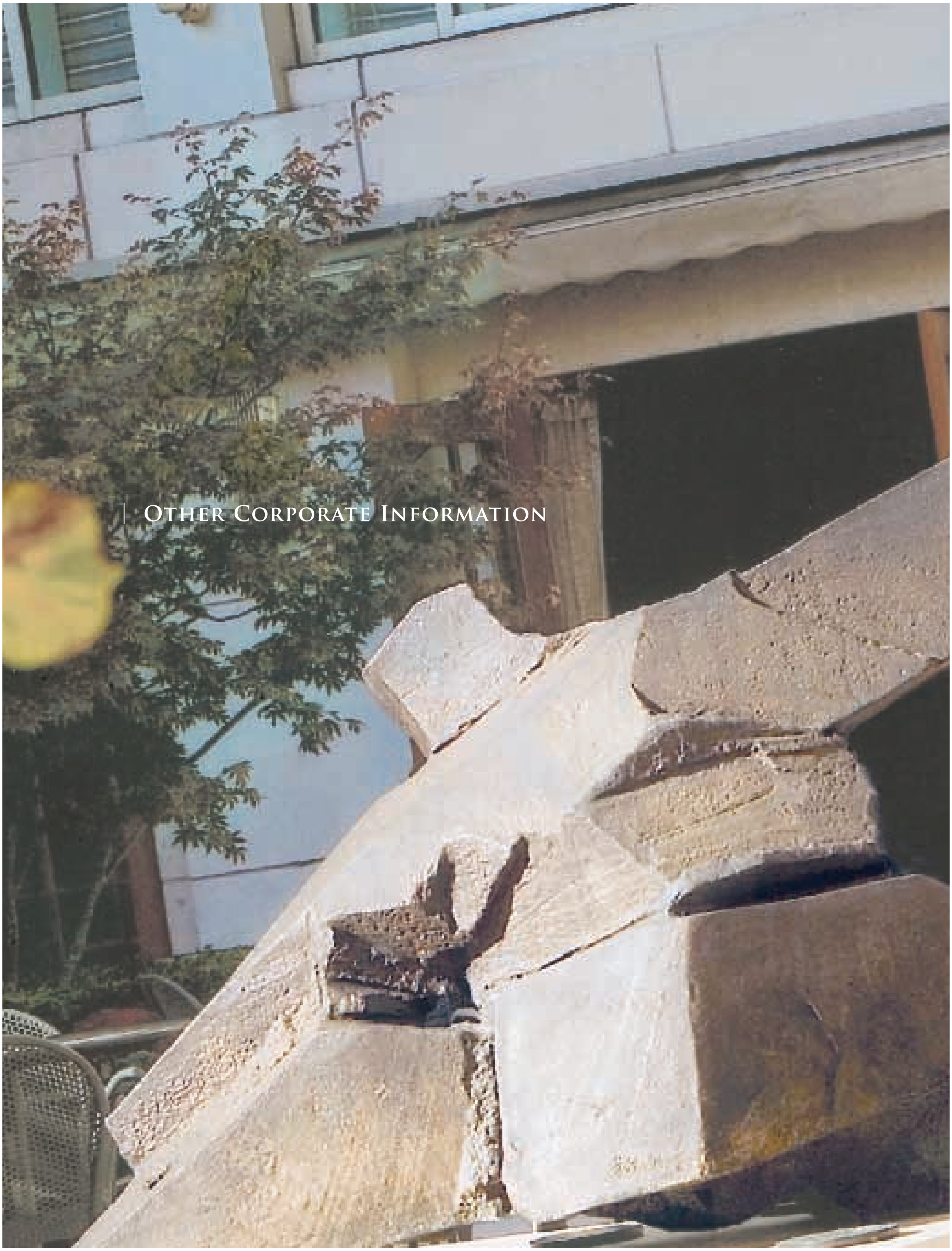
In 2006, the schematic designs for The Peninsula Shanghai were submitted and approved by the various relevant departments in the Shanghai Municipal Government. The construction permit was received from the Shanghai Construction Bureau in October and work subsequently commenced on the building's foundations, which will be finished in March 2007. Construction of the basement levels is expected to commence in February 2007.

The hotel occupies a site which will have a total gross floor area of 92,160 square meters (55,974 square meters above ground and 36,186 square meters below ground) and is located at 32 Zhong Shan Yi Road (East) with direct frontage onto the famous Bund. It will be a 15-storey building encompassing 250 guest rooms, three restaurants, banquet facilities, a spa, shopping arcade and a separate residential tower. The initial estimate of the total project cost for The Peninsula Shanghai Waitan Hotel Company Limited, which is 50% owned by the Company, is US$361 million, including total land price of US$109 million and related development and construction costs. The hotel is targeted for completion in 2009.

Ground breaking ceremony of The Peninsula Shanghai

The Peninsula Shanghai's construction site

Other Corporate Information



Directors

Chairman

The Hon. Sir Michael Kadoorie
GBS, LLD, Officier dans l'Ordre National de la Légion d'Honneur, Commandeur des Arts et des Lettres, Commandeur de l'Ordre de Léopold II
Aged 65. Appointed a Director in 1964 and elected Chairman in 1985. Sir Michael is also chairman of CLP Holdings Limited, a non-executive director of Hutchison Whampoa Limited, a director of Sir Elly Kadoorie & Sons Limited, as well as holding a number of other directorships. In addition, Sir Michael acts as a trustee of a number of leading, local charitable institutions. (E)

Deputy Chairman

Ian Duncan Boyce
Aged 62. A Fellow of the Institute of Chartered Accountants in England and Wales, he was appointed to the Board in 1999 and elected Deputy Chairman in May 2002. Mr. Boyce, based in Hong Kong since 1984, was formerly managing director of Schroders Asia and had held executive positions with the S.G. Warburg Group. He is non-executive chairman of Schroder Investment Management (Hong Kong) Limited, a director of CLP Holdings Limited and Tai Ping Carpets International Limited, and chairman of Sir Elly Kadoorie & Sons Limited. (E,A,F,R)

Chief Executive Officer

Clement King Man Kwok
Aged 47. A Bachelor of Science in Economics (London School of Economics) and a Member of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants, he joined the Group in February 2002 as Managing Director and Chief Executive Officer. Mr. Kwok's career began with Price Waterhouse and Barclays de Zoete Wedd in the United Kingdom, following which he returned to Hong Kong to work with Schroders Asia. Prior to joining the Group, he had served as finance director of MTR Corporation since 1996. He also serves as an independent non-executive director of Swire Pacific Limited, as well as on the Takeovers and Mergers Panel, the Takeovers Appeal Committee, the Securities and Futures Appeals Tribunal and the Board of the Community Chest. (E, F)

Executive Directors

Charles Mark Broadley
Aged 43. A Master of Arts in Law (Cambridge University), he joined the Group as Finance Director in November 2003. Prior to joining the Group, Mr. Broadley worked in the investment banking industry, both in the United Kingdom and, since 1990, in Hong Kong. His career began with Philips & Drew in London, followed by HSBC Investment Banking. Before moving to HSH, he was a managing director with N M Rothschild & Sons in Hong Kong. (F)

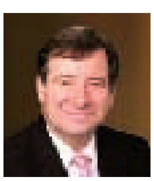
Peter Camille Borer
Aged 53. Appointed to the Board as an Executive Director in April 2004. A graduate of the Lausanne Hotel School, Switzerland, he joined the Group in 1981, enjoying senior roles in the Hong Kong and Bangkok hotel operations, as well as within the corporate office. He was appointed General Manager of The Peninsula Hong Kong in 1994, took on additional regional responsibility in 1999 and culminating in his appointment as Chief Operating Officer, The Peninsula Hotels, in April 2004.

Non-executive Directors

Ronald James McAulay
Aged 71. A graduate of the University of Glasgow, a Member of the Institute of Chartered Accountants of Scotland and brother-in-law of The Hon. Sir Michael Kadoorie, he was appointed to the Board in 1972. Mr. McAulay also serves on the board of CLP Holdings Limited, Sir Elly Kadoorie & Sons Limited and several other companies. Mr. McAulay is a trustee of the Tate Foundation in London and of various other charitable organizations. He is a member of the International Council of the Victoria and Albert Museum in London.

William Elkin Mocatta
Aged 54. A Fellow of the Institute of Chartered Accountants in England and Wales, he was appointed to the Board in 1985 and served as Deputy Chairman from 1993 until May 2002. Mr. Mocatta is an executive director of Sir Elly Kadoorie & Sons Limited and holds other non-executive positions including vice chairman of CLP Holdings Limited and chairman of CLP Power Hong Kong Limited.

Pierre Roger Boppe
Chevalier dans l'Ordre National de la Légion d'Honneur
Aged 59. A Master of Science from both the Swiss Federal Institute of Technology, Lausanne and Stanford University, he was Managing Director and Chief Executive Officer of the Group from 1996 until January 2002. Mr. Boppe is also non-executive deputy chairman of Kuoni Travel Holding Limited, and non-executive director of the hotel marketing association of Luxury Lifestyle Hotels and Resorts and Stein Management Company Limited.



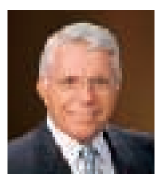
John Andrew Harry Leigh
Aged 53. A solicitor of the Supreme Courts of England, Hong Kong and Australia, he was appointed to the Board in May 2006. He serves on the boards of CLP Holdings Limited and Sir Elly Kadoorie & Sons Limited, overseeing a number of Kadoorie family interests in Hong Kong and overseas. (E, F)

Nicholas Timothy James Colfer
Aged 47. A Master of Arts and with over 23 years' experience of corporate management in the Asia-Pacific region, principally in real estate, manufacturing and distribution, he was appointed to the Board in May 2006. He is a non-executive director of Tai Ping Carpets International Limited, Sir Elly Kadoorie & Sons Limited and serves on several other corporate boards in Hong Kong.

Independent Non-executive Directors

Dr The Hon. Sir David Kwok Po Li
GBS, OBE, JP, Grand Officer of the Order of the Star of Italian Solidarity, The Order of the Rising Sun, Gold Rays with Neck Ribbon, Officier dans l'Ordre National de la Légion d'Honneur
Aged 68. Appointed to the Board in 1987, Sir David is chairman and chief executive of The Bank of East Asia, Limited and a director of numerous other companies in Hong Kong and overseas. Sir David is a member of both the Executive Council and the Legislative Council of Hong Kong. He is the chairman of The Chinese Banks' Association, Limited and of the Hong Kong Management Association. He is also a member of the Banking Advisory Committee and the Council of the Treasury Markets Association.

Robert Chee Siong Ng
Aged 54. Called to the English Bar in 1975, Mr. Ng was appointed to the Board in 1987. He is chairman of Sino Hotels (Holdings) Limited, which owns 3.6% of the Company's issued share capital. He is also chairman of Sino Land Company Limited and its holding company Tsim Sha Tsui Properties Limited. He is a non-executive director of SCMP Group Limited and a director of Yeo Hiap Seng Limited, which is listed in Singapore. (A)



Robert Warren Miller
Aged 73. A Bachelor of Science in Hotel Administration (Cornell University) and a presidential councillor and trustee emeritus of the University, he was appointed to the Board in July 2001. Mr. Miller, a resident of Hong Kong since 1960, is the founder of the DFS Group, Duty Free Shoppers Limited, and chairman of the Search Group, a private international investment group. (R)

Patrick Blackwell Paul, CBE
Aged 59. Appointed to the Board in February 2004. Mr. Paul began his career with Price Waterhouse in London in 1969. Resident in Hong Kong since 1980, he was chairman and senior partner of PricewaterhouseCoopers in Hong Kong from 1994 until 2001. He is an independent non-executive director of Johnson Electric Holdings Limited, Kingsway International Holdings Limited, Pacific Basin Shipping Limited and a member of the Managing Board of the Kowloon-Canton Railway Corporation. His civic commitments include chairing the Supervisory Board of the British Chamber of Commerce in Hong Kong. (A,R)

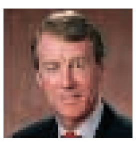
E **Executive committee members**
A **Audit committee members**
F **Finance committee members**
R **Remuneration committe members**

Senior Management & Key Functions

Group Management Committee

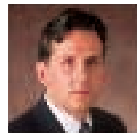
The Group Management Committee is tasked with making key decisions for the Company's management and operations, under official delegation of authority from the Board. The Committee is comprised of senior executives who are from various key functions and operations of the Company. In addition to Chief Executive Officer Clement K.M. Kwok, Chief Financial Officer C. Mark Broadley, and Chief Operating Officer Peter C. Borer, the following are members of the Group Management Committee:

Niklaus Leuenberger
Aged 52. Senior Vice President, The Americas for The Peninsula Hotels and General Manager of The Peninsula New York since 1992, Mr. Leuenberger holds regional responsibility for the Company's hotel operations in the USA. He joined the Company in 1980 and has held various positions in the Company's operations in Hong Kong, The People's Republic of China, and The Philippines.



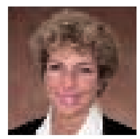
Martyn Sawyer
Aged 49. Group General Manager, Properties and Clubs since 1999, Mr. Sawyer holds responsibility for the Company's non-hotel properties and operations, including The Repulse Bay, The Peak Tower and The Peak Tram in Hong Kong, as well as properties and clubs in Hong Kong, Vietnam, and Thailand. He has been with the Company since 1985.

Operations General Managers



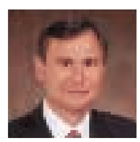
David Batchelor
Aged 49. Appointed General Manager of The Peninsula Manila in 2001 following seven years with The Peninsula Hong Kong, latterly as Resident Manager.

Rainy Chan
Aged 42. Ms. Chan joined the Company in 1994 and has been General Manager of The Peninsula Bangkok since 2004. She has been appointed General Manager of The Peninsula Hong Kong with effect from April 2007.



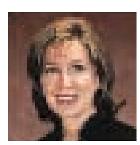
Sarah Cruse
Aged 44. Ms. Cruse joined the Company in 2006 as General Manager of Quail Lodge Resort and Golf Club.

Donald Harrington
Aged 54. Mr. Harrington joined the Company in 2000 as General Manager of The Peninsula Beijing.



Ali Kasikci
Aged 51. Mr. Kasikci is the Managing Director of The Peninsula Beverly Hills where he has been in charge of the hotel since 1992.

Charles Morris
Aged 52. Mr. Morris joined the Company in 2004 as Resident Manager of The Peninsula Manila and has been appointed General Manager of The Peninsula Bangkok with effect from March 2007.

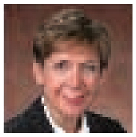


Maria Razumich-Zec
Aged 49. Ms. Razumich-Zec joined the Group as General Manager of The Peninsula Chicago in 2002.

Malcolm Thompson
Aged 56. Mr. Thompson joined the Group in 2006 as General Manager of The Peninsula Tokyo (scheduled to open in the autumn of 2007).

Palle Ledet Jensen
Aged 43. Mr. Jensen joined the Company in 1998 and was appointed General Manager of The Repulse Bay in 2005.

Corporate General Managers



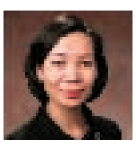
Jean Forrest
Aged 43. Ms. Forrest joined the Company in 2005 as General Manager, Marketing and is responsible for developing and implementing global marketing strategies for The Peninsula Hotels.

Shane Izaks
Aged 44. Mr. Izaks was appointed General Manager, Information Technology in 1995 and is responsible for formulating and implementing information technology strategy at both Group and operational levels.

Carlos Kusaka
Aged 47. Mr. Kusaka joined the Company in 2003 as Project Director, Tokyo.

Christobelle Liao
Aged 38. Ms. Liao joined the Company as Company Secretary and Corporate Counsel in 2002.

John Miller
Aged 47. Mr. Miller joined the Company in 1988 and was appointed General Manager, Design and Planning in 2002. His responsibilities include managing the design and planning of new and existing hotel developments.



Zuleika Mok
Aged 45. Ms. Mok was appointed General Manager, Human Resources in 2002 and is responsible for mapping the Company's human resources needs and overseeing employees' training and career progression.

Paul Tchen
Aged 40. Mr. Tchen joined the Company in 1992 and was appointed General Manager, Operations Planning and Support in 2007. He is also General Manager of Peninsula Merchandising Limited and Peninsula Cosmetics Limited.

Eymon Tsang
Aged 38. Mr. Tsang joined the Company in 1995 and was appointed General Manager, Corporate Finance and Treasurer in 2002. He is responsible for financial reporting and control, liquidity and financial risk management, and treasury activities.

David Williams
Aged 57. Mr. Williams joined the Company in 1998 and was appointed Head of Audit and Risk Management in 2004, with the responsibility to provide assurance services on the effectiveness of internal controls and the management of risks.

Wong Kin Keung
Aged 59. Mr. Wong joined the Company in 1994 and was appointed General Manager of The Peninsula Shanghai Waitan Company Limited in 2005. He also continues to act as General Manager, Project Coordination and Technical Services.

The 20 Tokyo Peninsula Ambassadors (standing) with the Group's senior executives

Employee Development and Benefits

The Group regards its loyal and experienced staff to be its most important asset. Significant investment and efforts are made into staff training, career development, staff well-being and staff communications, taking account of local culture and traditions as far as possible. As a result, the Group enjoys strong loyalty from its staff with many very long-serving members and indeed, successive generations of employees.

- The Group's staff orientation video, titled *Portraits of The Hongkong and Shanghai Hotels*, won a Gold Award and came second in the Public Relations category at the 39th Annual WorldFest – Houston Film Festival in April 2006.
- Wherever a Peninsula hotel operates, local traditions are honoured through a range of employee activities. For example, in Thailand there were staff celebrations at The Peninsula Bangkok during Songkran and Loy Krathong Festivals, and activities were organised to pay respect to the Thai monarch on the 60th anniversary of His Majesty's accession to the throne. At The Peninsula Manila, the hotel established a unique concept, the Pen Coop – which acts as an investment house for current and retired hotel employees, and training ground for casual employees.
- The spirit of camaraderie was celebrated across the Group. At The Peninsula Chicago, more than 150 employees from the hotel's opening team celebrated their fifth year of employment with the hotel in 2006. In Asia, The Peninsula Manila's Pen-Fam Fair and the annual Pen Sports were organised for employees and their families. The Peninsula Bangkok initiated a 'Make it Better' programme which provided staff with an excellent channel of communication to make suggestions for improvements.
- At Quail Lodge, a new contract was agreed with the union which would see an increase in productivity from housekeeping staff. At the same time, steps were taken to enhance staff welfare including the construction of a new staff dining room.
- Training remained a highly important component of the Peninsula fabric. This was especially important to hotels facing intense competition, which would rely on training to stay ahead of competitors. One such example was The Peninsula Beijing which has in recent years offered a significantly enhanced programme of training opportunities at its Centre for Learning and Development. Similarly, The Peninsula Chicago created several unique staff development programmes, including HEAR (for handling guest complaints) and TIPS (for alcohol service and intoxication prevention).
- An important recruitment and training regime was undertaken by The Peninsula Hong Kong for new spa staff which continued into the first half of the year. By the time the Spa opened in May 2006, the hotel had successfully hired 45 staff, who underwent intensive pre-opening training conducted by ESPA to ensure that the highest professional standards were met. A Spa Awareness pre-opening campaign was conducted for all hotel

employees in April. The activities included briefing sessions, an open day and a spa quiz.

- The Peninsula Hong Kong and The Peninsula Bangkok provided ongoing intensive training for the 20 Peninsula Tokyo Ambassadors, who embarked on their ten-month training in September 2006. They will be bringing their experience back to Tokyo in time for the opening of The Peninsula Tokyo in the autumn of 2007.
- Recruitment for The Peninsula Tokyo's management team has been concluded and the full team will be on board by April 2007. Arrangements have been made for the newly-appointed key executives to undergo in-depth orientation and cross-exposure programmes at the Head Office and The Peninsula Hong Kong. The efforts will continue in the first half of 2007.
- Almost all the Peninsula hotels provided cross exposure training to staff from sister hotels and properties. Overall demand and training days recorded a historical high in 2006, and has proved to be a very effective training tool for the operations to exchange useful tips on best practices and service standards. Internships to students from local and sometimes international hospitality schools were provided by The Peninsula Hong Kong, and by The Peninsula Chicago to The Hong Kong Polytechnic, (US) Kendall College and the Illinois Institute of Art.

Community Relations

It is a fundamental culture of the Group that its businesses are embodied in the local communities of the places where we operate. The philosophy of our hotels is to provide excellent facilities for the local community to utilise and enjoy, and through this, we become actively involved in community relationships and contribute to many worthwhile causes. The nature and extent of involvement are varied and depend on local circumstances and requirements. A flavour of our many different contributions is provided below.

- In Hong Kong, HSH Group General Manager, Properties and Clubs Martyn Sawyer took on a commitment to race across four deserts spread around the world in a bid to raise HK$1 million for Camp Quality Hong Kong, a local charity which takes children suffering from cancer out of their hospital environment and allows them to enjoy outdoor activities. His first race, through the Sahara Desert, took place in November 2006 and raised HK$360,000. In a bid to lend additional support to the charity, The Repulse Bay sponsored a Christmas Carnival for 250 children suffering from cancer.
- Other Group operations in Hong Kong gave to the community. Two teams from The Peninsula Hotels participated in the 2006 Trailwalker and raised more than HK$210,000 for Oxfam, the highest fundraiser in the Tourism Category for the third consecutive year. Other more significant contributions included: a painting competition titled 'My View of Hong Kong', organised by The Peak Tower to search for the community's most talented young artists in primary and special schools, with the winning works displayed at The Peak Tower's new Sky Gallery; the 'Tree of Hope' programme organised across all Peninsula Hotels, which spanned most of December and raised more than HK$300,000 for Make-A-Wish Foundation, which benefits children; and The Hong Kong Bankers Club raising funds for the Children's Cancer Foundation through its 25th Anniversary Party.
- Elsewhere across Asia, The Peninsula Beijing donated to The Children's Village

A Peninsula Hotels team at Oxfam Trailwalker 2006

which provides shelter, sustenance and education for children whose parents are imprisoned; the Thai Country Club donated half a million Baht to the Chacheongsao Special School for the construction of a new classroom building; and in the Philippines where the Bicol Region was ravaged by Typhoon Durian, HSH and The Peninsula Manila jointly donated 2 million Philippine Pesos to the Philippine National Red Cross for relief aid. The hotel also donated woollen blankets to the villagers of Naswak, Neuva Vizcaya.

- HSH staff also contributed to the local communities in their private capacity. Chief Executive Officer Clement Kwok serves on the Board of Directors of The Community Chest of Hong Kong, a major charitable organisation in Hong Kong. Group General Manager, Human Resources Zuleika Mok serves on the Advisory Board of the Hong Kong Polytechnic University's School of Hospitality Management, and on the Youth Services Committee of The Hong Kong Federation of Youth Groups; and the Chief Security Manager from The Peninsula Bangkok conducted fire escape trainings for community schools in his private capacity.
- In North America, The Peninsula New York staff gave to the American Cancer Society and Shelter Our Sisters, a charity which provides shelter to women and children escaping from domestic violence. In the Mid West, The Peninsula Chicago contributed to a wide range of charitable organisations either in kind or by way of staff participation, including the Howard Brown Health Centre which provides HIV relief services, Midwest Eye Bank, the Chicago Abused Women's Coalition, and 'adopted' charities such as the Lupus Foundation of America (Illinois Chapter). In Los Angeles, The Peninsula Beverly Hills staff participated in the Los Angeles Marathon and Tour de Palm Springs bicycle race to benefit a host of local charities, and fundraised for the American Cancer Society and The Maple Counseling Centre.

The Environment

The Group is fully committed to playing its part in protecting the environment, in relation to which the efforts of our operations are focused on waste re-cycling and energy conservation. The Group also actively promotes the use of natural nutritional ingredients and has developed Naturally Peninsula, a special nutritional programme for its guests.

- At The Repulse Bay complex in Hong Kong, a waste recycling programme was implemented in the residential buildings, club house and shopping arcade. Participation from residents was especially encouraging. The Peninsula Chicago adopted the city's Blue Bag method in terms of waste management, which separates all bottles and cardboard before the waste is shipped to landfills. And in Thailand, The Peninsula Bangkok began using output from the sewage treatment plant for fertilization and watering of the hotel's garden.
- Significant waste recycling efforts were put in by The Peninsula New York, which in 2006 recycled a total of 203 tons of

office paper, newspapers, magazines, cardboard, bottles and cans. This would be equivalent to an approximate savings of US$30,000 in a year, apart from saving 1,147 trees, 23,625 gallons of oil and 425,000 gallons of water.

- Energy conservation measures were also adopted in several operations. At The Repulse Bay complex, a range of energy conservation measures resulted in a reduction in electricity consumption by 7.1% as compared to 2005. The Peninsula New York started electricity saving measures in November 2006, and the full 12-month impact can be assessed in the coming year. The Peninsula Chicago installed a VFD for Chiller which would reduce the electricity load when the temperature falls below 85 degrees Farenheit. The hotel can now control the heating/cooling draw on all offices, meeting spaces and restaurants when they are not occupied. A plate and frame system was also in place to operate free cooling in the autumn and spring months.
- In terms of water control, The Peninsula Manila minimised the usage of deep well pumps to less than 30% of the hotel's daily water consumption, in order to contribute to the government's effort in protecting the depleted water table. The hotel also replaced the CO2 fire suppression system with environmentally-friendly chemicals to comply with the government's Clean Air Act.
- The Group's seven Peninsula Hotels introduced Naturally Peninsula in their dining establishments. Naturally Peninsula advocates light and healthy cuisine options, using organic food and beverages wherever possible. A registered dietician was also made available for guest consultation to develop personalised daily menus to meet individual taste and health requirements.
- Marrying environmental consciousness with health awareness, The Peninsula Beverly Hills began using trans-fat free in preparation of all menu items throughout the hotel.

Health and Safety

Employee health and safety requirements are set at the highest standards. The Group has well-established health and safety practices in place throughout its operations, which come under the responsibility of experienced and specifically-appointed safety and security managers, with regular audits also being conducted.

- During the year, Regional Managers of Risk Management visited all the hotel properties and reported on issues that need to be addressed. Audits were conducted on security, safety, health and hygiene, to ensure the safety and security of employees and guests, and to safeguard assets for our shareholders through minimising risk for damages or litigation to our operations and ensuring business continuity.
- The Internal Audit Department also examined working practices, particularly in hazardous environments, to ensure that safety standards are adhered to.
- Individual properties have their own customised safety and evacuation plans. Fire safety is of the highest priority, with specialist fire alarm and control systems and training for all employees. For instance, St. John's Building continued to be upgraded in line with the latest fire and building regulations; and at The Repulse Bay, extensive work has been undertaken on the fire prevention and detection systems which are scheduled to be completed by the end of 2007.

Consolidated Balance Sheet at 31.12.2005

	HK$m
Net assets	
Fixed assets	20,561
Other long-term investments	666
Deferred tax assets	123
Derivative financial instruments	25
Cash and bank balances	301
Other current assets	296
	21,972
Bank overdrafts	(16)
Bank borrowings	(2,598)
Derivative financial instruments	(209)
Deferred tax liabilities	(2,577)
Other liabilities	(966)
	15,606
Capital and reserves	
Share capital and premium	3,394
Retained profits	11,037
Hedging reserve	(15)
Other reserves	480
	14,896
Minority interests	710
	15,606

Consolidated Cash Flow Statement for the year ended 31.12.2006

		HK$m
1 EBITDA		1,281
Tax paid		(107)
Other adjustments		(10)
Cash inflow from operating activities		1,164
Interest and other financing charges paid		(184)
Dividends paid		(108)
2 Capital expenditure		(631)
Loan granted to jointly controlled entity		(14)
Net decrease in bank borrowings		(91)
Other net cash inflow		12
Net increase in cash		148
Cash and bank balances	301	
Less: Bank overdrafts	(16)	
Cash & cash equivalents at 1.1.2006		285
Cash & cash equivalents at 31.12.2006*		433

* Representing:

	HK$m
Cash and bank balances	447
Bank overdrafts	(14)
	433

Consolidated Income Statement for the year ended 31.12.2006

	HK$m
3 Turnover	3,723
Operating costs before depreciation and amortisation	(2,442)
1 EBITDA	1,281
Depreciation and amortisation	(251)
Financing charges	(125)
Share of loss of jointly controlled entity	(1)
Profit before non-operating items	904
4 Increase in fair value of investment properties	1,442
Reversal of impairment losses, net	200
4 Taxation	(423)
Minority interests	(29)
Profit attributable to shareholders	2,094

Consolidated Retained Profits for the year ended 31.12.2006

	HK$m
Retained profits at 1.1.2006	11,037
Profit attributable to shareholders for the year	2,094
Dividends paid during the year	(213)
Retained profits at 31.12.2006	12,918

Consolidated Balance Sheet at 31.12.2006

	HK$m
Net assets	
Fixed assets	22,951
Other long-term investments	685
Deferred tax assets	98
Derivative financial instruments	31
Cash and bank balances	447
Other current assets	397
	24,609
Bank overdrafts	(14)
Bank borrowings	(2,509)
Derivative financial instruments	(214)
Deferred tax liabilities	(2,880)
Other liabilities	(1,227)
	17,765
Capital and reserves	
Share capital and premium	3,499
Retained profits	12,918
Hedging reserve	(18)
Other reserves	583
	16,982
Minority interests	783
	17,765

1 EBITDA

EBITDA increased by 17% compared to 2005. The favourable result was mainly due to the positive operating performance of all business segments which is further described in 3 set out below.

2 Capital expenditure

Capital expenditure mainly comprised costs incurred in the Peninsula Tokyo project, ongoing renovation work incurred in respect of existing properties of the Group and the purchase of the new fleet of Rolls Royce Phantoms for The Peninsula Hong Kong.

3 Turnover

Turnover of the Group increased by 14% compared to 2005.

In Asia, most hotels have enjoyed buoyant business conditions. The Peninsula Hong Kong, the Group's flagship hotel, has had a record year in room revenue with RevPAR increasing by 14% to HK$2,592. The Peninsula Beijing, which completed its re-branding exercise during the year, has also increased its RevPAR by 19% to HK$958. The Peninsula Bangkok was faced with a more challenging environment during 2006 owing to the military coup. Despite this, the hotel was able to achieve reasonable revenue growth by 8% over 2005. The Peninsula Manila has undergone a major renovation with one entire tower and the hotel lobby closed completely for more than half a year. Due to the disruption caused by the renovation, revenue of the hotel showed a decline of 2% against 2005 whilst RevPAR of the hotel reduced by 2% to HK$484.

In the USA, strong demand has resulted in higher room rates in most properties. The Peninsula New York maintained its high occupancy levels, with room rates 11% above 2005. The Peninsula Chicago also continued to improve its leading RevPAR position compared with its competitive set, while being recognised in leading travel surveys. Management of Quail Lodge was resumed with effect from 1 April 2006, and the financial results of the resort have shown promising improvement.

The non-hotel segment has benefited from the strong demand for luxury residential units and commercial and office spaces in Hong Kong. Leases for the unfurnished apartments at The Repulse Bay were renewed with increased rates. In 2006, average occupancy and average rental per square foot increased by 9% and 21% to 94% and HK$34 respectively. The commercial space at The Repulse Bay remained fully let. The Peak Tower has completed its 14-month renovation, and was reopened in phases from July 2006. The newly renovated tower has achieved 100% occupancy and average rental per square foot at HK$42 was 50% above that before the renovation. St. John's Building was fully occupied from March 2006, with a positive increase in overall revenues and unit rates. In Vietnam, occupancy remained high and rates increased further in the office and residential space in The Landmark.

The Group's other business segment includes the operation of The Peninsula Clubs and Consultancy, restaurant outlets at The Repulse Bay, the Thai Country Club, the golf club located at Quail Lodge, The Peak Tramways and The Peninsula Merchandising. Revenues from this segment showed satisfactory growth in 2006 owing to the buoyant business environment.

4 Increase in fair value of investment properties

The Group states its investment properties in the balance sheet at fair value and recognises the gain or loss arising from changes in fair value in the income statement. The revaluation of the Group's investment properties has resulted in an increase in deferred tax liability and hence an additional tax charge of HK$249 million.

The Group's Financial Statements are compiled in accordance with Hong Kong accounting standards under a set of accounting policies which have been adopted as from 1st January, 2005. The Directors wish to draw the attention of the users of these Financial Statements to the following aspects of these accounting policies:

- Deferred taxation has been provided, at the profits tax rate, in respect of revaluation surpluses on the Group's investment properties which are mainly held in Hong Kong. It is the Directors' position that the Group's investment properties are held for the long term and that if any Hong Kong investment properties were sold, tax would not be payable on such disposal as the gain would be capital in nature and such gains are subject to a nil tax rate in Hong Kong. The Directors therefore expect that the provision for deferred taxation in respect of revaluation surpluses for Hong Kong investment properties, amounting to HK$2,407 million as at 31 December 2006, would not materialise.
- Hotel properties (other than shopping arcades and offices within the hotels) and golf courses are stated at cost less depreciation and any provision for impairment, rather than at fair market value. In order to provide shareholders with additional information on the value of the Group's net assets, the Directors have commissioned an independent third party fair market valuation of the Group's hotel properties and golf courses as at 31 December 2006, the details of which are set out on pages 57 and 58. If these assets are stated at fair market value instead of at cost less depreciation and any provision for impairment (and deferred tax is not provided on the revaluation surplus of the hotel property in Hong Kong on the same rationale as above), the Group's net assets attributable to shareholders would increase by HK$2,452 million.

In the light of the above, the Directors have provided for shareholders' additional information a calculation of the Group's adjusted net asset value as at 31 December 2006 on the basis set out below:

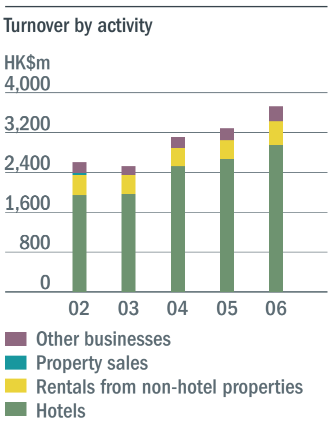
HK$m		
Net assets attributable to shareholders per audited balance sheet		16,982
Writing back the deferred taxation provision in respect of revaluation surpluses on Hong Kong investment properties		2,407
Adjusting the value of hotels and golf courses to fair market value	3,127	
Less: Related deferred tax and minority interests effects	(675)	
		2,452
Adjusted net assets attributable to shareholders		21,841
Audited net assets per share (HK$)		11.89
Adjusted net assets per share (HK$)		15.29

The comparative figure for adjusted net assets as at 31 December 2005 is not meaningful and has not been disclosed as no fair valuation was conducted for hotels and golf courses as at that date.

The Directors believe that the Company's profit and loss account and earnings per share include a number of items which are non-operating and/or non-recurring in nature, such as revaluation surpluses arising on investment properties and the gain on sale of The Kowloon Hotel in 2005. As the Group continues to be managed with principal reference to its underlying operating cash flows and recurring earnings, the Directors have also provided a calculation of the Group's earnings per share excluding non-operating items on the basis set out below:

HK$m	**2006**	2005
Profit attributable to shareholders	**2,094**	2,664
Net revaluation surplus on investment properties	**(1,189)**	(895)
Net impairment provision adjustments for hotels, golf courses and other properties	**(144)**	(85)
Gain on sale of The Kowloon Hotel	**–**	(991)
Other non-operating items	**–**	(52)
Earnings excluding non-operating items and related tax and minority interests effects	**761**	641
Earnings per share excluding non-operating items (HK$)	**0.54**	0.45

Income Statement



Turnover

The total turnover of the Group for the year of HK$3,723 million was 14% above 2005. When comparing year-on-year turnover it should be noted that The Peak Tower was closed for a substantial renovation project in April 2005 and re-opened in phases from July 2006, whilst The Peninsula Manila became a subsidiary of the Company in March 2005, as a result of which its results were consolidated for the first time as from that date, and the hotel was partially closed for renovation works for seven months in 2006.

The underlying 11% increase in turnover from the hotels was a positive performance, most of which was achieved through better yield performance giving rise to increases in average room rates. Positive consumer sentiment fuelled higher domestic patronage at many of our hotels, whilst international business and leisure travel continued to be strong.

With regard to our non-hotel properties, the continued strength of the Hong Kong and China economies resulted in sustained demand for office and residential space, as well as commercial space for high-end retail brands. The rental revenue of HK$464 million represents a 24% increase over 2005.

The table below sets out the breakdown of revenues by business sector and geographical segment:

HK$m	2006		2005	
Hotels				
Rooms	**1,455**	**39%**	1,297	40%
Food and beverage	**813**	**22%**	735	22%
Commercial rentals	**407**	**11%**	377	12%
Others	**275**	**7%**	257	8%
	2,950	**79%**	2,666	82%
Rentals from non-hotel properties				
Residential	**355**	**10%**	295	9%
Office	**42**	**1%**	36	1%
Shopping arcades	**67**	**2%**	43	1%
	464	**13%**	374	11%
Other businesses	**309**	**8%**	236	7%
	3,723	**100%**	3,276	100%
Arising in				
Hong Kong	**1,636**	**44%**	1,411	43%
Other Asia	**887**	**24%**	777	24%
United States of America	**1,200**	**32%**	1,088	33%
	3,723	**100%**	3,276	100%

Hotels During 2006, our majority-owned hotels ("owned hotels") generated total room revenue of HK$1,455 million, representing an increase of 12% over 2005. Food and beverage revenues rose 11% year on year, and commercial rental revenues rose by 8%.

The properties in Asia have enjoyed healthy business. The Peninsula Hong Kong achieved a record year in room revenue, with its average room rate increasing by 12% compared with 2005. In a more challenging environment following the military coup which occurred in September 2006, revenue for The Peninsula Bangkok was 13% ahead of 2005 until August 2006, but only finished 8% ahead for the year as a whole. The Peninsula Beijing achieved an 18% higher average room rate in 2006 and 16% higher revenue. The renovation of The Peninsula Manila disrupted revenue for the year, 2% down from 2005, but the enhanced room product has been warmly received by the hotel's customers and the hotel is looking forward to increased revenue from the renovated rooms.

In the USA, the buoyant market conditions have enabled all our properties to achieve higher room rates. The Peninsula New York maintained its high occupancy levels, with the average room rate 11% above 2005. The Peninsula Beverly Hills continued to lead its market in RevPAR, maintaining high occupancy and achieving record room rates. The Peninsula Chicago also continued to improve its leading RevPAR position compared with its competitive set, whilst gaining top accolades in leading travel surveys. From April 2006, HSH took over direct management of Quail Lodge and restructured the business, with gradually improving results.

Revenues from the hotels' shopping arcades have also increased over 2005 levels, reflecting improved consumer spending in high-end retail.

The breakdown of revenues by property is as follows:

HK$m	**2006** Rooms	F&B	Commercial rentals	Others	2005 Rooms	F&B	Commercial rentals	Others
Owned hotels								
The Peninsula Hong Kong	**312**	**291**	**282**	**72**	274	267	259	58
The Peninsula New York	**355**	**91**	**31**	**58**	319	82	29	64
The Peninsula Chicago	**302**	**176**	**–**	**60**	258	156	–	57
The Peninsula Bangkok	**136**	**71**	**2**	**13**	126	66	2	12
The Peninsula Beijing	**211**	**87**	**90**	**21**	178	70	84	21
The Peninsula Manila*	**88**	**60**	**2**	**23**	75	54	1	18
The Kowloon Hotel	**–**	**–**	**–**	**–**	18	7	2	1
Quail Lodge Resort	**51**	**37**	**–**	**9**	49	33	–	7
	1,455	**813**	**407**	**256**	1,297	735	377	238
Managed hotels**								
The Peninsula Beverly Hills	**267**	**95**	**–**	**51**	242	90	–	42
The Peninsula Manila*	**–**	**–**	**–**	**–**	14	11	–	3
	267	**95**	**–**	**51**	256	101	–	45
	1,722	**908**	**407**	**307**	1,553	836	377	283

Notes:

* *In 2005, 10 months' revenue from the Peninsula Manila was consolidated in the Financial Statements of the Group, following the acquisition of a majority share in the hotel. In 2006, 12 months' revenue was consolidated in the Financial Statements of the Group.*

** *Revenue on managed hotels is not consolidated in the Financial Statements of the Group. However, management and marketing fees of HK$19 million (2005: HK$19 million) were received from these hotels.*

Rentals from non-hotel properties Total rental revenue from non-hotel properties was HK$464 million, compared to HK$374 million in 2005. The bulk of the impact of the renovation of the unfurnished apartments at 109 The Repulse Bay was realised from the second half of 2006, following the cycle of rental reversions.

The Peak Tower re-opened in phases from July 2006, after being closed since the end of April 2005. The renovation has added some 30% more lettable space and, with a different market mix, has attracted significantly higher rental rates with 100% occupancy by the year-end. There has been strong demand for the renovated facility.

St. John's Building was fully occupied from March 2006, with a positive increase in overall revenues and unit rates. There has been significant growth in the rates charged for rental space in Central, Hong Kong, and rental revenue increased by 28% over 2005. Occupancy remained high and rates increased further in the office and residential space in The Landmark, Vietnam.

The breakdown of revenues by property is as follows:

HK$m	**2006** Residential	Office	Shopping arcade	2005 Residential	Office	Shopping arcade
The Repulse Bay complex, Hong Kong	**344**	**–**	**37**	284	–	36
The Peak Tower, Hong Kong	**–**	**–**	**29**	–	–	7
St. John's Building, Hong Kong	**–**	**23**	**–**	–	18	–
The Landmark, Ho Chi Minh City	**11**	**19**	**1**	11	18	–
	355	**42**	**67**	295	36	43

Other businesses Revenue from the Thai Country Club was 27% above 2005, and the Club received excellent press coverage for the Volvo Masters in December. The Peak Tram enjoyed record breaking annual patronage of 4.43 million people, up 13% from 2005, with revenues 14% higher. Income from the restaurants at The Repulse Bay improved by 13% over 2005, driven largely by an exceptionally high level of banqueting business. The Cathay Pacific Lounges have been operated directly by HSH since June 2006, which has favourably impacted the Peninsula Clubs and Consultancy Services' revenue and profits. Peninsula Merchandising has seen revenues increasing by 59% to HK$27 million over 2005, with increasing revenue derived from Peninsula Boutiques in the hotels and franchised operations in department stores and an airport.

Revenue from other businesses is analysed as follows:

HK$m	**2006**	2005
The Peak Tram	**66**	58
The Repulse Bay restaurants	**62**	55
Cathay Pacific Lounges	**47**	–
Thai Country Club	**52**	41
Quail Lodge golf course	**30**	31
Others	**52**	51
	309	236

Operating costs (%)

Staff costs and related expenses	44
Others	27
Rent and utilities	10
Cost of inventories	11
Depreciation & amortisation	9

Operating costs

Operating costs of HK$2,693 million is 11% above 2005, mainly due to the higher business volumes which have impacted the cost of inventories and led to higher payroll costs in order to service the increased business.

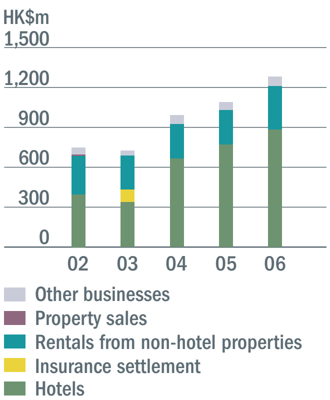
HK$1,181 million or 44% of direct operating costs are payroll-related, up from 42% in 2005. The breakdown of employee numbers at 31 December was as follows:

	2006			2005		
	Direct operations	**Managed operations**	**Total**	Direct operations	Managed operations	Total
Hotels	**4,190**	**411**	**4,601**	3,919	415	4,334
Property	**316**	**–**	**316**	307	–	307
Other businesses	**611**	**393**	**1,004**	377	604	981
	5,117	**804**	**5,921**	4,603	1,019	5,622
Hong Kong	**1,638**	**393**	**2,031**	1,334	604	1,938
Other Asia	**2,414**	**0**	**2,414**	2,316	–	2,316
United States of America	**1,065**	**411**	**1,476**	953	415	1,368
	5,117	**804**	**5,921**	4,603	1,019	5,622

Depreciation

Depreciation during the year was HK$246 million (2005: HK$231 million), largely relating to the hotel properties as explained above. It should be noted that of this figure HK$110 million (2005: HK$101 million) relates to depreciation and amortisation of land and buildings, which would not be required if the hotels were accounted for on a fair market value basis instead of the cost and depreciation basis as currently adopted.

EBITDA by activity



EBITDA

EBITDA (earnings before interest, taxation, depreciation and amortisation) rose by 17% to HK$1,281 million, with good increases in all divisions. EBITDA can be analysed as follows:

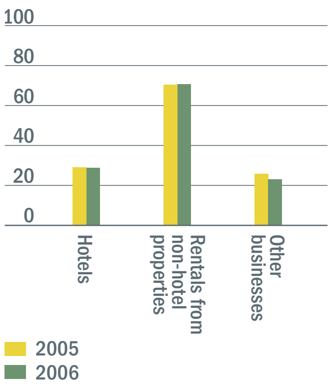
HK$m	Hong Kong	Other Asia	United States of America	Total
2006				
Hotels	**423**	**280**	**179**	**882**
Rentals from non-hotel properties	**310**	**18**	**–**	**328**
Other businesses	**58**	**17**	**(4)**	**71**
	791	**315**	**175**	**1,281**
2005				
Hotels	389	240	140	769
Rentals from non-hotel properties	246	17	–	263
Other businesses	51	13	(4)	60
	686	270	136	1,092

Hotels The hotels division performed strongly as consumer and corporate business volumes remained healthy in all markets. EBITDA for this division increased by 15% to HK$882 million. All hotels showed improved performance compared with 2005. The Peninsula Hong Kong and The Peninsula Beijing both performed strongly as compared to the previous year, whereas The Peninsula Manila increased its EBITDA despite the significant disruption from its renovation programme. The Peninsulas in New York and Chicago benefited from the continued rise in room rates while the loss at Quail Lodge Resort was reduced compared to 2005.

Rentals from non-hotel properties EBITDA arising from rentals in non-hotel properties increased by 25% to HK$328 million, driven largely by increases from residential lettings at The Repulse Bay and increased rentals following the reopening of The Peak Tower. St. John's Building and The Landmark also achieved satisfactory increases.

Other businesses EBITDA from other businesses increased by 18% to HK$71 million, mainly due to increased profit from The Peak Tram, which was positively impacted by the re-opening of The Peak Tower. Other businesses such as the Thai Country Club, Peninsula Clubs and Consultancy Services, Tai Pan Laundry and Peninsula Merchandising performed satisfactorily.

EBITDA margin (%)



EBITDA margin

EBITDA margin represents EBITDA as a percentage of turnover and is analysed as follows:

EBITDA margin	2006	2005
Hotels	**30%**	29%
Rentals from non-hotel properties	**71%**	70%
Other businesses	**23%**	25%
Overall profit margin	**34%**	33%
Arising in		
Hong Kong	**48%**	49%
Other Asia	**36%**	35%
United States of America	**15%**	13%

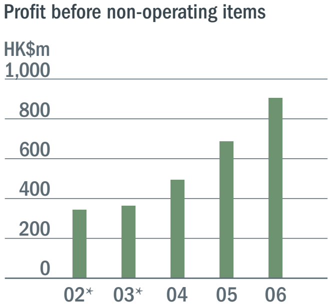
Efforts had been made throughout the year to ensure that operating costs were kept within budget, even as revenues increased above budget, in order to drive as much additional profit into the Group results as possible and compensate for the above inflation increases in some fixed operating and non-operating costs. There have been higher increases in some expenses due to factors outside our control, such as trade union-negotiated pay increases, land use rate increases and energy cost increases.

Margins have improved in most hotels in the Group, except for The Peninsula Bangkok which suffered reduced revenue and increased costs in the last four months of 2006 following the military coup. The margins in The Peninsula Bangkok until August 2006 were in line with 2005, and would otherwise have shown positive growth over a full normal year. The Peninsula Hotels in New York, Chicago, Manila and Beijing were all able to improve their margins over 2005.

Most businesses in the non-hotel properties segment recorded positive improvements in margin performance. Much of the increased turnover in The Repulse Bay complex was in residential revenue, which has a higher profit margin, and resulted in overall improved complex profitability. There was also positive growth in margins in The Peak Tower following its re-opening in July and in St. John's Building, whilst The Landmark maintained its profitability margin.

In the other business segment, the Cathay Pacific Lounges came under the Group's direct operation from 1 June. Although this resulted in more profit to the Group, the profit margin is much lower than other businesses. Without this change, the overall margin for this segment would have also shown positive growth compared with 2005.

Profit before non-operating items



*Figures for 2002 and 2003 are stated on the basis of the Company's old accounting policies, which were changed with effect from 1 January 2005 (with 2004 figures restated).

Profit before non-operating items

Profit before non-operating items grew significantly by 31% against 2005 to HK$904 million. This figure is one of the key measures that reflect the underlying performance of the Group, on which management focuses.

The growth in this profit figure was driven by the strong performance from all business segments across the Group, including hotel operations, commercial leasing, office premises, residential apartments, and other businesses. At the same time, reduction in the debt level led to a decrease in interest expenses, thereby further contributing to the profit growth.

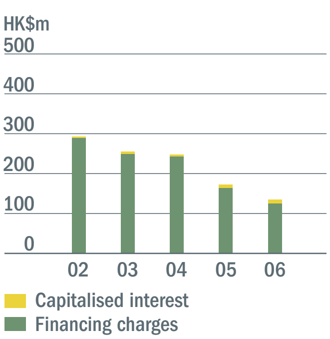
Non-operating items

Fair value changes on investment properties amounting to HK$1,442 million (2005: HK$1,089 million) were mainly attributable to the increase in value of properties in Hong Kong, being the apartments at The Repulse Bay, the shopping arcade at The Peninsula Hong Kong, St. John's Building and The Peak Tower.

The review by the Directors of the fair values and values in use of our hotel properties resulted in a net reversal of some impairment provisions that were previously recognised in the Financial Statements. The net reversal of impairment provisions for hotels, golf courses and other properties totalled HK$200 million (2005: HK$117 million) and arose largely from an increase in value of The Peninsula Chicago, given its strong earnings growth and outlook.

It should also be noted that in 2005, a net gain of HK$953 million was recorded in respect of the sale of The Kowloon Hotel and a gain of HK$60 million was recorded on the sale of land in Phuket. These were one-off transactions that did not recur in 2006.

Financing charges



Financing charges

Financing charges on borrowings in 2006 amounted to HK$134 million, of which HK$9 million was capitalised for The Peninsula Tokyo, The Peninsula Manila and The Peak Tower. The net charge of HK$125 million, which was 23% lower than 2005, was recognised in the income statement. The reduction in financing charges was due to the decrease of 10% in the amount of net borrowings during 2006.

The weighted average gross interest rate for the year remained at 5.0%, the same as in 2005. Interest cover has improved, with operating profit at 8.2 times (2005: 5.2 times) net financing charges for the year.

Taxation

The taxation charge for the year increased as compared to 2005 mainly due to the following reasons:

- The taxation on current year's operating profit increased due to the higher taxable earnings;
- The positive outlook on the availability of future earnings to utilise carried forward tax losses has given rise to further deferred tax credits of HK$43 million (2005: HK$110 million) in respect of unused tax losses, largely arising in the United States; and
- The increases in valuation of investment properties and other fixed assets have resulted in an increased deferred tax expense of HK$305 million (2005: HK$173 million).

The details of the taxation charge are as follows:

HK$m	2006	2005
Taxation on operating profit for the year	**157**	145
Tax adjustments related to prior years:		
Recognition of prior years' tax losses	**(43)**	(110)
Under-provision of current tax liabilities	**4**	–
Taxation on operating items	**118**	35
Deferred taxation on non-operating items	**305**	173
Taxation in the income statement	**423**	208

The deferred tax provision with respect to the accumulated valuation surplus on investment properties increased to HK$2,556 million, of which HK$2,407 million relates to Hong Kong properties. The Directors consider that the provision for deferred tax liabilities with regard to valuation surpluses on the Group's investment properties in Hong Kong will not materialise on the grounds that the Group has no intention to sell these properties; and should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in Hong Kong.

Balance Sheet

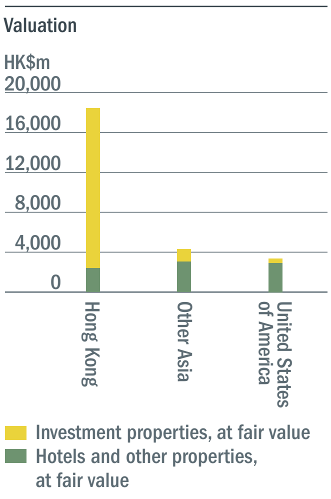
Non-current assets

The Group owns and manages eight hotels and resort in Asia and the USA, and is developing two more hotels in Tokyo and Shanghai. The Peninsula Tokyo will open in 2007.

In addition to hotel properties, the Group owns residential apartments, office towers and shopping arcades for rental purposes.

Hotel properties (other than shopping arcades and offices at 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. To provide additional information to shareholders on the current market value of our hotels and golf courses, the Directors have commissioned independent valuers to perform a fair valuation of these properties (except for The Peninsula Beverly Hills which is 20% owned by the Group) as at 31 December 2006. An independent valuation was also performed for the Group's investment properties as of 31 December 2006.

Accordingly, a summary of the Group's hotel, investment and other properties showing both the book value and the market value attributable to the Group at 31 December 2006 is set out in the following table:



	Total property GFA (sf)	Net lettable area: Shopping arcade (sf)	Net lettable area: Office (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)	Attributable book value (HK$m)
Hotels							
Owned hotels							
The Peninsula Hong Kong *Lease Expiry Jan-2072*	781,499	72,292	59,866	7,772	100%	7,772	6,257
The Peninsula New York *Lease Expiry Aug-2078*	305,870	7,574	–	1,743	100%	1,743	911
The Peninsula Chicago *Freehold/Leasehold*	403,219	–	–	1,322	92.5%	1,223	1,187
The Peninsula Bangkok *Freehold*	732,544	3,246	–	823	75%	617	621
The Peninsula Beijing *Lease Expiry Nov-2033*	790,902	78,703	–	2,020	42.13%	851	569
The Peninsula Manila *Lease Expiry Dec-2027*	921,203	10,473	–	326	76.09%	248	190
Quail Lodge Resort *Freehold*	1,664,460	–	–	165	100%	165	165
	5,599,697	172,288	59,866	14,171		12,619	9,900
Managed hotels							
The Peninsula Beverly Hills (at net cost)†				466	20%	93	
Total for hotels				14,637		12,712	

† *No fair valuation was carried out for The Peninsula Beverly Hills, which is 20% owned by the Group.*

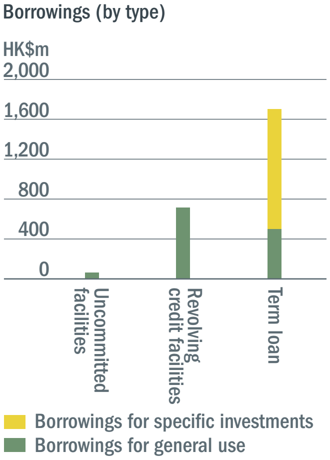
	Total property GFA (sf)	Net lettable area: Shopping arcade (sf)	Net lettable area: Office (sf)	Net lettable area: Residential (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)
Non-hotel properties for rental							
The Repulse Bay *Lease Expiry May-2068*	805,990	26,026	–	376,893	5,633	100%	5,633
Repulse Bay Apartments *Lease Expiry Mar-2071*	710,763	–	–	418,692	3,647	100%	3,647
Repulse Bay Garage *Lease Expiry Sept-2070*	36,438	16,934	–	–	79	100%	79
The Peak Tower *Lease Expiry Mar-2031*	116,546	67,254	–	–	746	100%	746
St. John's Building *Lease Expiry Aug-2114*	103,857	635	60,690	–	463	100%	463
The Landmark *Lease Expiry Jan-2026*	224,922	–	80,439	54,821	76	70%	53
Total for non-hotel properties for rental	1,998,516	110,849	141,129	850,406	10,644		10,621

	Total property GFA (sf)	Market valuation (HK$m)	HSH interest (%)	Attributable market value (HK$m)
Other properties				
Golf courses				
Thai Country Club *Freehold*	7,405,283	213	75%	160
Quail Lodge Golf Club *Freehold*	5,846,888	35	100%	35
Sub-total for golf courses	13,252,171	248		195
Vacant land				
Vacant land near Bangkok *Freehold*	15,040,030	313	75%	235
Quail Lodge land *Freehold*	15,470,337	80	100%	80
Sub-total for vacant land	30,510,367	393		315
Other properties in use				
Po Yip Building, Flat 2, 1/F *Lease Expiry Jun-2047*	20,594	16	100%	16
1 Lugard Road *Lease Expiry Jan-2077*	4,938	2	100%	2
Sun Hing Industrial Building, Units 1&2, 5/F *Lease Expiry Jul-2120*	4,694	3	100%	3
Sub-total for other properties in use	30,226	21		21
Total for other properties	43,792,764	662		531
Total	**51,390,977**	**25,943**		**23,864**

The revaluation surpluses on investment properties, including the shopping arcades and offices at the hotels, credited to the income statement in 2006, together with the balance of unrealised gains as at 31 December 2006, are summarised below:

Revaluation surplus		**2006**			2005
HK$m	**Surpluses**	**Deferred taxation**	**Minority interests**	**Net surpluses**	Net surpluses
Owned hotels					
The Peninsula Hong Kong	**520**	**(91)**	**–**	429	445
The Peninsula New York	**32**	**(9)**	**–**	23	19
The Peninsula Bangkok	**1**	**–**	**–**	1	1
The Peninsula Beijing	**29**	**(10)**	**(4)**	15	9
The Peninsula Manila	**–**	**–**	**–**	–	–
	582	**(110)**	**(4)**	468	474
Non-hotel properties					
The Repulse Bay complex	**624**	**(109)**	**–**	515	327
The Peak Tower	**137**	**(13)**	**–**	124	49
St. John's Building	**96**	**(17)**	**–**	79	36
The Landmark	**2**	**–**	**–**	2	(1)
	859	**(139)**	**–**	720	411
Vacant land					
Quail Lodge land	**1**	**–**	**–**	1	7
Vacant land near Bangkok	**–**	**–**	**–**	–	3
	1	**–**	**–**	1	10
Total valuation surpluses recognised for the year	**1,442**	**(249)**	**(4)**	1,189	895
Unrealised gains at 1 January				10,179	9,442
Realisation on asset disposal				–	(161)
Exchange differences				–	3
Unrealised gains at 31 December				11,368	10,179

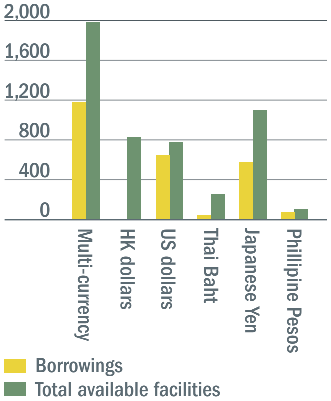
Borrowings (by type)



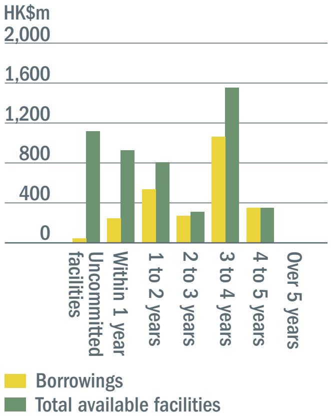
Borrowings

As at 31 December 2006, net borrowings had decreased by 10% as compared to 2005 to HK$2.1 billion due to the operating cashflows and retained earnings generated by the Company. This borrowing level remains well within the debt capacity of the Group.

Borrowings and available facilities (by currency)



Maturity profile



In addition to the Group's consolidated borrowings, The Peninsula Beverly Hills (20% owned) and The Peninsula Shanghai (50% owned) have obtained non-recourse bank borrowings, which are not consolidated in the balance sheet as the entities owning the assets are not subsidiaries of the Company. Consolidated and non-consolidated borrowings as at 31 December 2006 are summarised as follows:

Borrowings	**2006**				2005
HK$m	**Hong Kong**	**Other Asia**	**United States of America**	**Total**	Total
Consolidated borrowings					
For general use	**1,188**	**118**	**19**	**1,325**	1,535
For specific investments	**–**	**574**	**624**	**1,198**	1,079
Consolidated borrowings	**1,188**	**692**	**643**	**2,523**	2,614
Off balance sheet borrowings attributable to the Group, for specific investments					
The Peninsula Beverly Hills (20%)	**–**	**–**	**117**	**117**	119
The Peninsula Shanghai (50%)	**–**	**15**	**–**	**15**	–
Off balance sheet borrowings	**–**	**15**	**117**	**132**	119
Consolidated and non-consolidated borrowings	**1,188**	**707**	**760**	**2,655**	2,733
Pledged assets attributable to the Group					
For consolidated borrowings	**–**	**–**	**–**	**–**	1,315
For off balance sheet borrowings	**–**	**–**	**264**	**264**	269
	–	**–**	**264**	**264**	1,584

Derivative financial instruments

Derivative financial instruments are generally used to hedge interest rate and exchange rate risks of the Group. Derivative financial assets and liabilities are recorded at their fair value. There is no significant change in the fair value of the derivative financial assets and liabilities during 2006.

Cash Flow Statement

Net cash generated from operating activities increased to HK$1,164 million as compared to HK$1,058 million in 2005. Most of the operating cash flows were applied to capital expenditure and repayment of borrowings.

Capital expenditure in 2006 totalled HK$645 million and is summarised below:

HK$m	**2006**	2005
New project development – Tokyo	**194**	52
– Shanghai	**14**	308
Cash consideration for additional investment – Manila	**–**	12
Major renovations in certain properties	**290**	182
Capital expenditure at other existing properties	**147**	110
	645	664

Capital expenditure (%)

The Group spent HK$208 million on the developments of The Peninsulas in Tokyo and Shanghai. The development in Tokyo is progressing on schedule and the hotel is expected to open in the second half of 2007. Ground breaking of The Peninsula Shanghai commenced in October 2006, with first-stage financing obtained in December 2006. The second-stage financing is under negotiation with banks and will be finalised in 2007.

Major renovations totalling HK$290 million included redevelopment of The Peak Tower (which was re-opened in July 2006), renovation of guestrooms in The Makati Tower and other areas at The Peninsula Manila (which was completed in December 2006), spa projects at The Peninsulas in Hong Kong, Chicago and Bangkok (which opened in May, June and December 2006 respectively), and the purchase of 14 Rolls-Royce Phantoms in Hong Kong.

In addition, capital expenditure of HK$147 million was incurred on ongoing upkeep and minor capital projects at our existing properties.

The net cash inflow after interest and dividends before financing activities was HK$232 million for the year, compared to HK$1,928 million in 2005. It should be noted that the figure for 2005 included the sales of The Kowloon Hotel and other fixed assets, exclusive of which the net cash inflow for that year would have been HK$92 million. The increase in the net cash inflow on this comparative basis was mainly due to the improvement in the operating results, as well as reduction in interest expenses.

Treasury Management

All the Group's financing and treasury activities are centrally managed and controlled at the corporate level, where the majority of the Group's funding needs, currency, and interest rate risk exposures are monitored.

Within the same policy framework, some operating subsidiaries monitor financial risks that are specific to particular transactions within their operations. Associated and jointly-controlled companies arrange their own financial and treasury affairs based on their circumstances on a stand-alone basis.

Liquidity risk

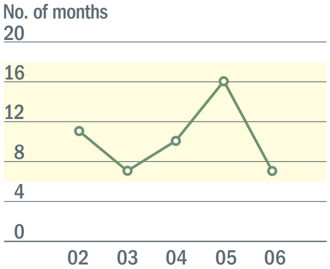
The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with loan covenants, and to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments.

Borrowing requirements are not seasonal as the Group benefits from a steady inflow of income from its leased properties, and there is only minor seasonality in its hotel operations. Borrowing requirements tend to follow the pattern of capital expenditure and investment. As such, the level of borrowing facilities is continuously monitored, at least on an annual basis, to ensure efficient bank facilities management. Appropriate funding action will normally be taken whenever there is any corporate activity with significant cashflow implication. In such circumstances all funding channels will be considered although, debt financing is the Group's main source of funding.

For prudence sake, committed facilities are preferred but uncommitted facilities may be considered where cost savings can be attained. Also, to allow for more flexibility, revolving loans are preferred but term loans may be considered where cost savings are available.

Financing horizon

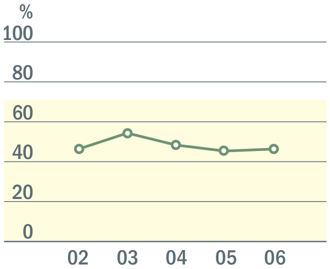
No. of months



Group guideline: 6-18 months

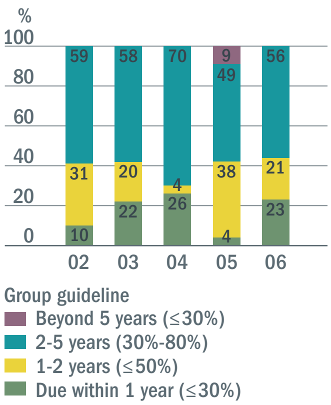
Top 3 banks' aggregated committed facility exposure

%

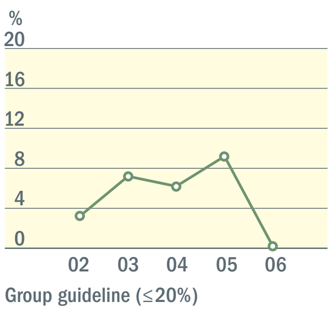


Group guideline (≤70%)

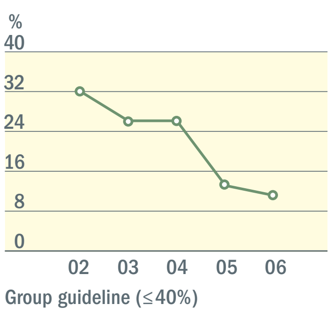
Maturity profile of committed facilities



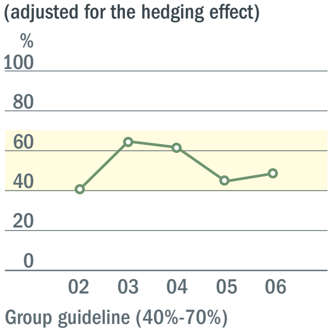
Borrowing facilities with asset pledge



Gearing



Long term fixed-to-total borrowings (adjusted for the hedging effect)



In addition, the Group maintains a well-balanced spread of maturities of borrowing facilities, mostly arranged on a medium to long-term basis to minimise the refinancing risk.

Generally speaking, mortgage or pledge of assets is not provided to secure borrowing facilities unless significant cost savings with acceptable risks can be obtained, such as project-based financing.

The Group's policy is that gearing, expressed as the percentage of net borrowings to the total of net borrowings and net assets, shall at all times remain below 40%. Care is taken to ensure that borrowing facilities do not impose onerous or restrictive covenants, and that the terms of the facilities match the underlying requirements. The Group's financial position is reviewed periodically to ensure compliance of loan covenants.

As at 31 December 2006, gearing decreased marginally to 11%, against 13% in 2005.

Interest rate risk

The Group's interest rate risk management policy focuses on reducing the Group's exposure to changes in interest rates. Moreover, under certain circumstances, such as in developing countries, it may be possible to make use of interest rate instruments to reduce the overall interest expenses.

In addition to raising funds directly on a fixed rate basis, the Group may use interest rate swaps in managing its long-term interest rate exposure. The policy of Fixed and Floating Rate Mix is between 40:60 and 70:30 with a long-term target of 50:50. This policy is subject to periodic review at least once a year.

The interest rates on 51% of the Group's borrowings (including anticipated borrowings that are hedged by interest rate instruments with future effective dates) were fixed on 31 December 2006.

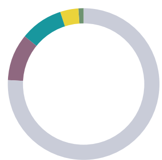
Foreign exchange risk

Significant exposure to movements in exchange rates on individual transactions is monitored and may be hedged by using spot or forward foreign exchange contracts where active markets for the relevant currencies exist. All significant foreign currency borrowings are usually covered by appropriate currency hedges. Accordingly, the Group does not have any unhedged borrowings denominated in non-functional currencies, other than US$ borrowings in Hong Kong.

Translation exposure arising on consolidation of the Group's overseas net assets is reduced, where practicable, by matching assets with borrowings in the same currency or by any other means.

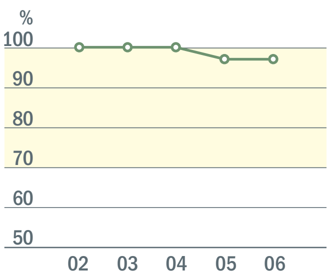
The long-term financial obligations of the Group's entities are normally arranged in currencies in which they have substantial positive operational cash flows, thereby establishing natural currency hedges.

Net assets (%)



HK dollars	76
US dollars	10
Chinese Renminbi	9
Thai Baht	4
Phillipine Pesos	1

Bank deposit at counterparties having credit ratings of at least investment grades



Group guideline (≥70%)

As at 31 December 2006, after accounting for currency hedging, approximately 76%, 9%, 10%, 4% and 1% of the Group's net assets were denominated in Hong Kong dollars, Chinese Renminbi, United States dollars, Thai Baht and Philippine Pesos respectively.

Credit risk

Under normal circumstances, when depositing surplus funds or entering into derivative contracts, the Group manages its exposure to non-performance of counterparties by transacting with counterparties which have a credit rating of at least an investment grade. However, in developing countries, it may be necessary to deal with banks of lower credit ratings.

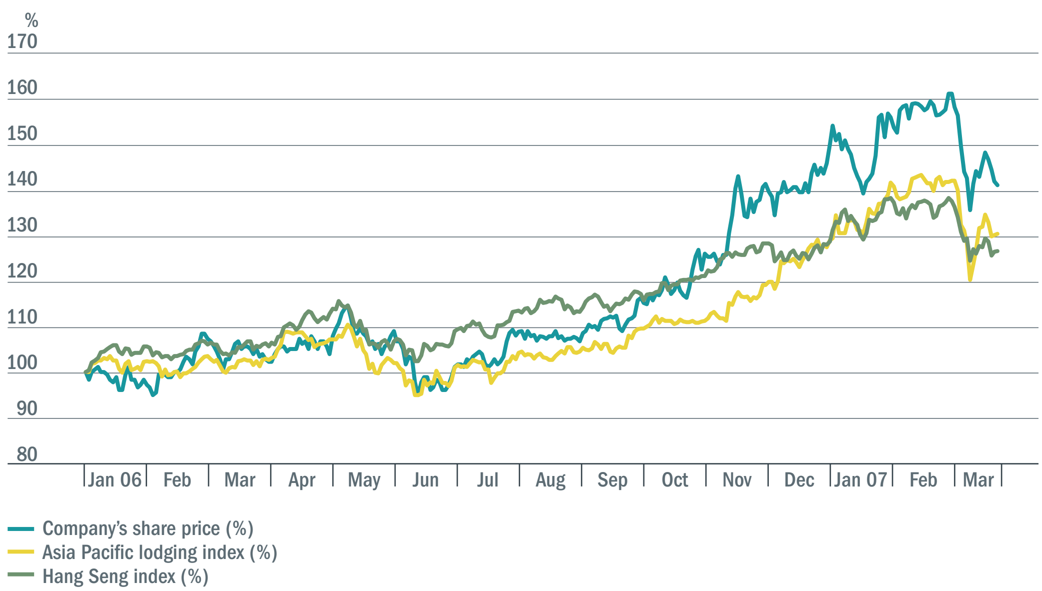
Derivatives are used solely for hedging purposes and not for speculation, and the Group only enters into derivative transactions with counterparties which have credit ratings of at least investment grades, even in developing countries, because of the longer term effect.

Share Information

The Company's share price closed on 15 March 2007 at HK$12.22, giving a market capitalisation of HK$17.5 billion (US$2.3 billion) and reflecting a premium of 3% to net assets attributable to shareholders of the Company. This also represents a discount of 20% to adjusted net assets.

During 2006, the share price outperformed the Hang Seng Index and an index of leading Asia Pacific hotel stocks.

Share price & indices



Note: The share price and indices as at 31 December 2005 = 100%

Ten Year Financial Summary

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Consolidated Income Statement (HK$m)										
Turnover	**3,723**	3,276	3,120	2,517	2,592	2,584	3,043	3,610	2,140	2,779
EBITDA	**1,281**	1,092	992	726	747	698	925	745	889	1,144
Profit before non-operating items	**904**	688	495	364	344	230	369	213	562	786
Profit/(loss) attributable to shareholders	**2,094**	2,664	2,786	351	293	33	85	569	(1,832)	118
Dividends	**(228)**	(199)	(168)	(112)	(93)	(58)	(59)	(59)	(58)	(443)
Earnings per share (HK$)	**1.47**	1.89	1.99	0.29	0.25	0.03	0.07	0.49	(1.58)	0.10
Earnings per share excluding non-operating items (HK$)	**0.54**	0.45	0.28	0.24	0.23	0.15	0.28	0.13	0.62	0.58
Dividends per share (HK cents)	**16¢**	14¢	12¢	8¢	8¢	5¢	5¢	5¢	5¢	38¢
Dividend cover (times)	**9.2x**	13.4x	16.6x	3.1x	3.2x	0.6x	1.4x	9.6x	–	0.3x
Interest cover (times)	**8.2x**	5.2x	3.1x	2.5x	2.2x	1.7x	1.9x	1.5x	3.6x	7.4x
Consolidated Balance Sheet (HK$m)										
Fixed assets	**22,951**	20,561	20,058	19,068	18,019	17,338	18,365	16,910	15,326	22,126
Other assets	**1,211**	1,110	741	771	712	1,025	1,334	2,239	2,822	3,062
Cash and bank balances	**447**	301	262	217	232	99	272	132	152	103
Total assets	**24,609**	21,972	21,061	20,056	18,963	18,462	19,971	19,281	18,300	25,291
Interest-bearing borrowings	**2,523**	2,614	4,536	4,906	5,843	5,755	5,968	6,555	6,854	5,524
Derivative financial instruments	**214**	209	–	–	–	–	–	–	–	–
Other liabilities	**4,890**	4,253	4,183	1,709	1,543	764	914	945	1,081	1,224
Net assets attributable to shareholders	**16,982**	14,896	12,342	13,441	11,577	11,943	13,089	11,781	10,365	18,543
Net assets per share (HK$)	**$11.89**	$10.51	$8.80	$9.59	$9.90	$10.22	$11.18	$10.18	$8.96	$15.94
Gearing	**11%**	13%	26%	26%	33%	32%	30%	35%	39%	23%
Consolidated Cash Flow (HK$m)										
Net cash generated from operating activities	**1,164**	1,058	992	627	772	863	1,453	1,418	350	736
Capital expenditure	**645**	664	360	436	276	537	618	527	788	773
Net cash inflow/(outflow) after interest and dividends before financing activities	**232**	1,928	427	(156)	229	30	503	395	(1,177)	(831)
Share Information										
Highest share price (HK$)	**$13.30**	$9.35	$7.50	$5.60	$4.35	$5.40	$5.30	$7.70	$7.40	$15.15
Lowest share price (HK$)	**$8.05**	$7.40	$4.15	$2.78	$2.63	$2.03	$3.40	$4.53	$3.15	$5.30
Year end closing share price (HK$)	**$13.14**	$8.50	$6.95	$4.53	$3.30	$2.90	$4.30	$5.15	$5.50	$6.40

Notes:

1. *The results for all years prior to 2004 are stated on the basis of the Company's old accounting policies, which were changed with effect from 1 January 2005 (with 2004 figures restated).*
2. *Figures for years 1997 to 2001 have not been restated in respect of HKAS 12 Income Taxes or SSAP 12 (Revised) Income Taxes as it is not practicable to quantify the effects for those earlier years.*

The Company is committed to fulfilling its responsibilities to shareholders by ensuring that the proper processes for oversight and management of its businesses are in place, in operation and are regularly reviewed. The Board acknowledges its responsibility to ensure that good corporate governance practices and procedures are established.

The Company welcomes the principles-based approach of the Code on Corporate Governance Practices (CG Code) in Appendix 14 of the Listing Rules and the flexibility this provides concerning the adoption and implementation of corporate policies and procedures.

Throughout the year, the Company has complied with all the code provisions and the majority of the recommended best practices as set out in the CG Code. In March 2005, the Company adopted its own code on corporate governance which was updated in October 2005 and which encompassed all code provisions and most of the recommended best practices in the CG Code.

One of the recommended best practices that the Company has deviated from is contained in Section C.1.4 of the CG Code in relation to the production of quarterly statements. The Company has chosen not to comply with this recommended reporting practice as the Board believes that, as a matter of principle and practice, quarterly reports in relation to the Group's business promote an undue short term focus in a business which is long term in nature. The Company would review its position if and when there was a clear demand from shareholders for quarterly reporting.

The Board

The Company is controlled through the Board, which has the overall responsibility for leadership and control of the Company. The Directors are collectively responsible for promoting the success of the Company by directing and supervising the Company's affairs.

Board composition The Board has 14 Directors: three Executive Directors – Mr. Clement K. M. Kwok, Mr. C. Mark Broadley and Mr. Peter C. Borer; seven Non-Executive Directors comprising Chairman The Hon. Sir Michael Kadoorie, Deputy Chairman Mr. Ian D. Boyce, Mr. Ronald J. McAulay, Mr. William E. Mocatta, Mr. Pierre R. Boppe, Mr. John A. H. Leigh, and Mr. Nicholas T. J. Colfer; and four Independent Non-Executive Directors comprising Dr. The Hon. Sir David K. P. Li, Mr. Robert C. S. Ng, Mr. Robert W. Miller and Mr. Patrick B. Paul. The Directors' biographical details are set out on pages 38 and 39 and are also posted on the Company's website at www.hshgroup.com.

The Board believes that the balance between Executive and Non-Executive Directors is reasonable and adequate to provide sufficient checks and balances that safeguard the interests of shareholders and the Group. The Company already exceeds the minimum required number of Independent Non-executive Directors on the Board, and welcomes the contribution that they make at the Board and other Board Committee levels in the exercise of their experience, knowledge and judgement.

Included in the composition of the Board are two family members of the majority shareholder: the Chairman, The Hon. Sir Michael Kadoorie and his brother-in-law, Mr. Ronald J. McAulay. Several Board members are also directors of other businesses with which the majority shareholder is connected. They are: Mr. Ian D. Boyce, Mr. William E. Mocatta, Mr. John A. H. Leigh and Mr. Nicholas T. J. Colfer.

Board meetings The Board meets regularly to review business development and overall strategic policies. Within the Board's purview are matters such as financial statements, dividend policy, major financings, material investments in new projects and existing assets, risk management strategy, acquisitions, treasury policy and changes in accounting policy.

The dates of the 2006 Board meetings were determined in the last quarter of 2005 and any amendments to this schedule were notified to Directors at least 14 days before a regular Board meeting. Suitable arrangements are in place to allow all Directors the opportunity to include matters for discussion in the agenda of each Board meeting. An agenda and accompanying Board papers are sent to all Directors at least three days in advance of every Board meeting.

The Company Secretary assists the Chairman in preparing the agenda for the meeting and ensures that all applicable rules and regulations regarding the meetings are followed.

The Board held four meetings during 2006. The attendance record of each Director is set out below:

	No. of meetings attended	
Attendance at board meetings	**2006 (4 meetings in total)**	2005 (5 meetings in total)
Non-Executive Directors		
The Hon. Sir Michael Kadoorie (Chairman)	**4**	4
Mr. Ian D. Boyce (Deputy Chairman)	**4**	5
Mr. Ronald J. McAulay	**2**	5
Mr. William E. Mocatta	**4**	5
Mr. Pierre R. Boppe	**3**	3
Mr. John A. H. Leigh (appointed 05/06)	**2 (of 2)**	–
Mr. Nicholas T. J. Colfer (appointed 05/06)	**2 (of 2)**	–
Sir Sidney Gordon (retired 05/06)	**0 (of 2)**	1
Mr. James S. Dickson Leach (retired 05/06)	**0 (of 2)**	5
Independent Non-Executive Directors		
Dr. The Hon. Sir David K. P. Li	**4**	3
Mr. Robert C. S. Ng	**1**	2
Mr. Robert W. Miller	**3**	5
Mr. Patrick B. Paul	**4**	5
Executive Directors		
Mr. Clement K. M. Kwok (Chief Executive Officer)	**4**	5
Mr. C. Mark Broadley	**4**	5
Mr. Peter C. Borer	**4**	5

The Directors have full access to relevant information both at the meetings and at regular intervals as material information becomes necessary to the exercise of their powers. They also have unrestricted access to the advice and services of the Company Secretary, who is responsible for providing Directors with Board papers and related materials and ensuring that Board procedures are followed.

The Company Secretary also keeps detailed minutes of each meeting, recording all matters considered by the Board, the decisions reached, and any concerns raised or dissenting views expressed by Directors. Draft minutes are sent to all Directors in a timely manner for their comment and final versions of the minutes are available for inspection by all Directors at any time.

Should a potential conflict of interest involving a substantial shareholder or a Director arise, the matter will be discussed in an actual meeting, as opposed to being dealt with by written resolution. Independent Non-Executive Directors with no conflict of interest will be present at meetings dealing with such conflict issues.

Appointment, re-election and removal A new Director appointed by the Board is subject to election by shareholders at the next annual general meeting. All Non-Executive Directors have letters of appointment valid for a period of three years, subject to re-election on retirement by rotation. All Directors are subject to retirement by rotation and may offer themselves for re-election. During 2006, one third of the Directors, comprising Sir Sidney Gordon, Mr. Ronald J. McAulay, Dr. The Hon Sir David K. P. Li and Mr. C. Mark Broadley retired by rotation and, save for Sir Sidney Gordon who had not sought for re-election, were all re-elected. In addition, Non-Executive Director Mr. James S. Dickson Leach retired voluntarily at the annual general meeting and did not seek re-election. Details of the Directors who will offer themselves for re-election in 2007 are set out in the Directors' Report.

Confirmation of independence The Company has received from Dr. The Hon. Sir David K. P. Li, Mr. Robert C. S. Ng, Mr. Robert W. Miller and Mr. Patrick B. Paul, Independent Non-Executive Directors, an annual written confirmation of independence, and the Company considers such Directors to be independent in accordance with the independence guidelines set out in rule 3.13 of the Listing Rules. Although two of the Independent Non-Executive Directors, Dr. The Hon. Sir David K. P. Li and Mr. Robert C. S. Ng have served in this capacity for more than nine years, the Directors are of the opinion that the two Directors continue to bring relevant experience and knowledge to the Board and that, notwithstanding their long service, maintain an independent view of the Company's affairs.

Chairman and Chief Executive Officer The positions of Chairman and Chief Executive Officer are segregated. It is the responsibility of the Chairman to provide leadership for the Board and to ensure that it works effectively and discharges its responsibilities. It is the responsibility of the Chief Executive Officer to effect the policies agreed by the Board, to advise the Board of any material issues which might impact the Company, and to conduct the day-to-day running of the Company.

Responsibilities of Directors

Directors are encouraged to update their skills, knowledge and familiarity with the Group through their initial induction, ongoing participation at Board and Board Committee meetings, and through meeting key people at head office and in various properties.

Each Director ensures that he can give sufficient time and attention to the affairs of the Group. All Directors disclose to the Board on their first appointment their interests as a Director or otherwise in other companies or organisations and such declarations are updated annually.

Directors' interests in competing business None of the Directors and their respective associates has any competing interests which need to be disclosed pursuant to rule 8.10 of the Listing Rules.

Directors' responsibilities for the financial statements The Directors are responsible for the preparation of the financial statements for each financial period which gives a true and fair view of the state of affairs of the Group and of the results and cash flows for that period. In preparing these financial statements for the year ended 31 December 2006, the Directors have selected suitable accounting policies and applied them consistently, made judgements and estimates that are prudent, fair and reasonable and prepared the financial statements on a going concern basis. The Directors are responsible for ensuring that the Group keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group.

Dealing in Company's securities by Directors In February 2004, the Company adopted its Code for Dealing in the Company's Securities by Directors (the "Securities Code") on terms no less exacting than the required standard set out in the Stock Exchange's Model Code for Securities Transactions by Directors of Listed Issuers in Appendix 10 of the Listing Rules ("Model Code"). The Company has also extended this code to specified employees.

A copy of the Securities Code is sent to each Director of the Company first on his appointment. Thereafter, one month before the date of the Board meetings to approve the Company's half-year result and annual result, each Director is reminded of his duties not to deal in the securities of the Company until after such results have been published, and that all his dealings must be conducted in accordance with the Securities Code.

Under the Securities Code, Directors and specified employees of the Company are required to notify the Chief Executive Officer or in his absence, the Chief Financial Officer and receive a dated written acknowledgement before dealing in the securities of the Company, and in the case of the Chief Executive Officer himself, he must notify the Chairman and receive a dated written acknowledgement before any dealing.

The Company has made specific enquiry of all Directors regarding any non-compliance with the Model Code and the Securities Code during the year, and they have confirmed that they have fully complied with the required standard set out in both Codes.

In July 2006, the Company was informed by Sir Elly Kadoorie & Sons Limited ("SEK") that The Hon. Sir Michael Kadoorie, Messrs. Ian D. Boyce, Ronald J. McAulay, William E. Mocatta, John A. H. Leigh and Nicholas T. J. Colfer, Directors of the Company (in their capacities as directors of trustee companies or fiduciaries of a number of trust structures), would be involved in a complex trust restructuring which would trigger a number of filings under the Securities and Futures Ordinance and related notifications to the Company ("Kadoorie Family Trust Restructuring") during the month before the Company's result announcement ("Blackout Period") and the Stock Exchange had granted a conditional waiver to the foregoing Directors of the Company from strict compliance with the provisions of the Model Code during the Blackout Period. Part of the Kadoorie Family Trust Restructuring took place during the Blackout Period in September 2006. SEK confirmed to the Company that the Kadoorie Family Trust Restructuring did not involve acquisition of the Company's new shares, or any outside consideration or changes to the beneficiaries.

The Board Committees

As part of good corporate governance practice, a number of Board Committees have been established. These Committees include representation from Non-Executive and Independent Non-Executive Directors whose objective views are important to the execution of the controls expected of a publicly listed company. Each Committee operates within defined terms of reference; these terms of reference are posted on the Company's website at www.hshgroup.com. All Committees report to the Board in relation to their decisions, findings or recommendations, and in certain specific situations, to seek the Board's approval before taking any action. Draft minutes of all Board Committee meetings are sent to their respective members in a timely manner for their comments and final versions of the minutes are available for inspection by the respective members at any time.

The Board delegated certain authorities to the Executive, Audit, Finance and Remuneration Committees. The day-to-day management of the Company's business has been delegated to the Chief Executive Officer who exercises his authority in consultation with the Group Management Committee.

Executive Committee The Executive Committee meets at least twice per month. The Committee is responsible for recommending general policy and direction for the Company to the Board and as such, it interacts with the Audit, Finance and Remuneration Committees in respect of their policy submissions. The members of the Executive Committee comprise The Hon. Sir Michael Kadoorie, Committee chairman, Mr. Ian D. Boyce, Mr. Clement K. M. Kwok, and Mr. John A. H. Leigh.

The Company does not have a separate Nomination Committee; the nomination and appointment of new Directors are functions of the Executive Committee. The Executive Committee reviews on a regular basis the need to appoint Directors with specific business acumen in appropriate sectors that would further enhance the present skill set, or add expertise in a developing business sector.

Nominations of suitable candidates are invited from all Directors, and nominees are considered by the Executive Committee and then by the Board. In May 2006, Messrs. John A. H. Leigh and Nicholas T. J. Colfer were appointed as Non-Executive Directors of the Company.

Audit Committee The Audit Committee oversees the Company's financial reporting and audit processes through liaison and reviews with management and the internal and external auditors. The composition of the Audit Committee includes only Non-Executive Directors of which the majority are independent. The Audit Committee members are Mr. Patrick B. Paul, Committee chairman, Mr. Ian D. Boyce, and Mr. Robert C. S. Ng.

All members of the Committee have financial and/or legal backgrounds that enable them to assess the fiscal well-being of the Company, compliance and risk assessment as well as to act impartially in discharging their duties and responsibilities. No former partner of the Company's existing auditing firm acted as a member of the Audit Committee within one year from ceasing to be a partner or having any financial interest in the auditing firm.

During 2006, activities undertaken by the Audit Committee included the following:

- reviewed the completeness and accuracy of the 2005 annual report and the 2006 interim report;
- oversight of the financial reporting and audit processes and policies;
- reviewed the Group's financial controls, internal control and risk management systems;
- reviewed connected transactions of the Company;
- agreed the scope of internal audit for 2006, discussed the internal audit reports and matters arising from the reports and reviewed progress against recommendations made in the internal audit reports;
- conducted discussions with the external auditors on financial reporting, compliance, accounting treatment and impact on the Company of accounting standards;
- assessed the independence of external auditors and reviewed their policies for maintaining independence;
- approved the external auditors' remuneration and considered its re-appointment;
- approved the audit plan for 2007; and
- reported all relevant matters to the Board.

The Audit Committee invited the Company's external auditors to attend all its meetings and also met with the valuers of the principal assets of the Group. In addition, the chairman of the Audit Committee met with the external auditors with no Executive Directors present. He also met with the Chief Executive Officer, the Chief Financial Officer and divisional heads within the Company.

The Audit Committee held five meetings during 2006. The attendance record of each member appears below:

Attendance at audit committee	No. of meetings attended **2006 (5 meetings in total)**	2005 (5 meetings in total)
Mr. Patrick B. Paul (Committee chairman)	**5**	5
Mr. Ian D. Boyce	**5**	5
Mr. Robert C. S. Ng	**2**	2

Finance Committee The Finance Committee meets at least twice per month to review all aspects of the Company's finances, including such items as new investments or project commitments, establishment of budget parameters, major treasury policies (including debt levels, gearing and foreign exchange risk), granting of guarantees and indemnities and reviewing the annual insurance programme of the Group. It exercises the delegated authority granted to it by the Board and reports to the Executive Committee and to the Board as necessary. Members of the Finance Committee are: Mr. Ian D. Boyce, Committee chairman, Mr. Clement K. M. Kwok, Mr. C. Mark Broadley and Mr. John A. H. Leigh.

Remuneration Committee The Remuneration Committee is composed solely of Non-Executive Directors of which the majority is independent. Committee members are Mr. Ian D. Boyce (chairman), Mr. Robert W. Miller, and Mr. Patrick B. Paul.

The Remuneration Committee meets at appropriate intervals to formulate and recommend remuneration policy to the Board, including group-wide remuneration policies, reviewing the competitive terms and conditions of employment of the Chief Executive Officer and the Executive Directors, and making recommendations on compensation-related and human resource issues. No Director plays a part in any discussions about his own remuneration.

The Committee is provided with benchmark reports from internal and external sources for evaluation of market trends and the competitive levels of remuneration being offered to Executive Directors and staff. The Committee weighs compensation, performance-related bonuses and retirement provisions against market norms and sets parameters on what is fair for the Company to support, and competitive within the appropriate markets in which it operates. Fees and benefits for Non-Executive Directors are evaluated given the pool of qualified candidates, the demand for their services, their potential contribution to the development and oversight of the Company, and market practice.

The Remuneration Committee met twice during 2006. The attendance record of each member appears below:

Attendance at remuneration committee	No. of meetings attended 2006 (2 meetings in total)	2005 (2 meetings in total)
Mr. Ian D. Boyce (Committee chairman)	**2**	2
Mr. Robert W. Miller	**1**	1
Mr. Patrick B. Paul	**2**	2

During 2006, the Remuneration Committee reviewed matters relating to remuneration for Directors and senior management, as well as discussed the Group's remuneration policy.

The Group does not have any long-term incentive schemes other than the retirement scheme described in note 30 to the financial statements. Additional information on the basis of determining the emoluments payable to the Directors and senior management is set out in note 8 to the financial statements.

The Company has not adopted any share option scheme during the year.

Internal Controls, Audit and Risk Management

The Board has overall responsibility for the Company's system of internal control over financial, operational and compliance issues, risk management processes and physical and information systems security. The Board has reviewed the effectiveness of the Group's internal control system, to ensure that appropriate levels of protection are in place. No significant areas of concern were identified.

Internal controls The Company Management Authority Manual that was introduced in 2003, dealing with the Company's approval processes and the limits of authority for managers and Board Committees, is reviewed and updated from time to time to ensure its continuing relevance and effectiveness in controlling expenditure and approving the strategic direction of the Company.

The Chief Executive Officer reviews the effectiveness of the internal audit function and the systems of internal control of the Company on an annual basis. The annual review considers the following:

- the changes since the last annual review in the nature and extent of significant risks and the Group's ability to respond to changes in its business and the external environment;
- the scope and quality of management's ongoing monitoring of risks and of the systems of internal control, and where applicable, the work of its internal audit function and other providers of assurance;
- the extent and frequency of the communication of the results of monitoring to the Audit Committee or the Board which enables it to build up a cumulative assessment of the state of control in the Company and the effectiveness with which risk is being managed;

- the incidence of significant control failings or weakness that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the Company's financial performance or condition; and
- the effectiveness of the Company's public reporting processes.

On an annual basis, general managers and financial controllers of each business unit are required to submit a general representation letter to the Chief Executive Officer and the Chief Financial Officer giving certification of compliance by themselves and their subordinates of successful implementation of all internal systems of control and procedures in their respective units, and to provide supplementary information should there be any departure from the internal control systems. These general representation letters reinforce personal responsibility for good governance and controls at all levels within the Group.

Internal audit and risk management The Company's Internal Audit and Risk Management Department assists the Board in conducting internal reviews of the Company and its subsidiaries in respect of all material controls, including operational and compliance controls, financial controls and risk management functions. It further assists in complying with the Company's own code on corporate governance.

The head of the Department reports to the Chief Executive Officer and has access to the chairman of the Audit Committee. He is supported by four qualified professionals, a majority of whom are members of the Institute of Internal Auditors. The Department provides the Board and all levels of Company management with an independent assessment of the quality of the internal controls, risk assessments, and governance issues and provides recommendations for continuous improvement.

The Department's three-year audit plan is annually revised to reflect organisational changes as well as new business activities introduced in the previous year. The audit plan, designed to cover all auditable areas whether of a financial, legal, reputational, environmental, information technology, safety or security nature, is reviewed and approved by the Audit Committee annually.

The Department follows a risk-and-control-based approach. Different audit areas are assigned risk ratings and an audit plan is formulated in a risk-weighted manner so that priorities and appropriate audit frequency is given to areas with higher risks. During 2006, the Department conducted audits and reviews of ten business units, four projects, nine head office functions and one overseas corporate-owned entity. Summaries of major audit findings and control weaknesses, if any, are discussed with management.

Every quarter, the Department submits a summary of these internal audit findings, the recommendations and the status of implementation of recommendations to the Audit Committee for its review. The head of the Department also attended two of the five Audit Committee meetings held during 2006; and attended regular meetings with the chairman of the Audit Committee and the external auditors without the presence of management. In the opinion of the Audit Committee, nothing of a material nature arose in the Department's reports requiring that it be brought to the attention of shareholders.

External Auditors

It is important to the Group that the independence of its external auditors is not compromised. Contracts for substantial non-audit work to be awarded to the external auditors must, therefore, be pre-approved by the Audit Committee and the scope of work determined to provide only efficiencies of scale and added value, with no adverse effect on actual or perceived independence of the audit work itself. During the year, the Company's auditors, KPMG, provided audit services to the value of HK$6.6 million. KPMG also provided taxation services to the value of HK$0.7 million.

Code of Conduct

The Company has a detailed code of conduct, to which employees are signatories, governing the standards of behaviour expected in dealing with colleagues, customers, suppliers, contractors, consultants and professional firms.

A broad summary of the code of conduct is published on the Group's website at www.hshgroup.com, covering the Group's policies on the following areas: bribery, illegal gifts and commissions, accepting/offering advantages, entertainment and hospitality industry practice, use of proprietary information, handling conflict of interest situations, insider trading, misuse of the Company's assets and resources, loans, personal conduct outside hours of work including outside employment, monitoring of compliance and the means of enforcement, understanding and compliance of the code of conduct, violation of the code of conduct, and complaints.

In addition to the values to which the Company expects its staff to adhere in their daily business practices, the code sets out the process for resolution of internal ethical problems that may arise within the workplace. The code is reviewed regularly and benchmarked against emerging mores and standards as the work environment becomes more sophisticated, and as technological advances create new behavioural dynamics.

Investor Relations

The Company is keen to promote two-way communications both with its institutional and its private investors. The Annual General Meeting ("AGM") is the principal occasion at which the Chairman and Directors may interface directly with the shareholders. An AGM circular is distributed to all shareholders at least 21 days prior to the AGM, setting out details of each proposed resolution, voting procedures (including procedures for demanding and conducting a poll) and other relevant information. All Directors are usually present at the AGM to which all shareholders are invited and during which they have the opportunity to raise questions with the Board.

During the year, continuous dialogue between investors and the Company on the Company's business is encouraged. As part of a regular programme of investor relations, Executive Directors and our General Manager of Corporate Finance and Treasurer hold briefings and attend road-shows with investors and financial analysts to engage in two-way communications on the Company's performance and objectives. Archived webcasts and copies of presentation materials from such briefings, and webcasts of the meetings announcing the interim and final results of the Company are made available to investors and public through the corporate website.

Communication with shareholders is a high priority. The annual report and accounts and the interim report are distributed to individual and institutional investors and are also available for download from the Company's website at www.hshgroup.com. General enquiries from shareholders are handled by designated employees within the Company.

At the 2006 AGM, held at noon on Thursday, May 18 at The Peninsula Hong Kong, separate resolutions were proposed on the following issues:

- to receive the audited financial statements and the reports of the Directors and auditors, for the year ended 31 December 2005;
- to declare a final dividend;
- to re-elect three Directors and to elect two Directors;
- to re-appoint KPMG as auditors of the Company at a fee to be agreed by the Directors;
- to grant a general mandate to issue new shares;
- to grant a general mandate for share repurchase; and
- to add shares repurchased to the general mandate given to issue new shares.

Each resolution was voted on by poll and passed and the results of the poll voting were posted on the Company website as well as published in the media the following day.

In addition to the shareholders, media are also invited to attend and report on the AGM.

The key dates in the corporate results and meetings calendar are also posted on the Company's website in advance. The important dates for 2007 are:

- Annual General Meeting: Friday, 11 May 2007
- Interim Results 2007 Announcement: Wednesday 12 September 2007.

Details of the public float are set out in the Directors' Report on page 84.

The Directors have pleasure in submitting their Report together with the audited financial statements for the year ended 31 December 2006.

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 48 to 63.

Ten Year Financial and Operating Summaries

Summaries of the Group's financial and operating data for the last ten years are set out on pages 4 and 64.

Financial Statements

The profit of the Group for the year ended 31 December 2006 and the state of the Company's and the Group's affairs as at that date are set out in the Financial Statements on pages 86 to 147.

Share Capital

On 23 June 2006 and 17 November 2006, pursuant to scrip dividend schemes, the Company issued and allotted 5,903,392 shares and 5,010,424 shares respectively at an issue price of HK$9.33 and HK$10.128 each to the shareholders who elected to receive shares of the Company in lieu of cash for the 2005 final and 2006 interim dividends in respect of the year ended 31 December 2005 and the six months ended 30 June 2006, 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 25 to the financial statements.

Dividends

An interim dividend of 5 cents per share was paid during the year 2006. The Directors have recommended a final dividend of 11 cents per share. Subject to the approval by shareholders at the forthcoming Annual General Meeting to be held at The Peninsula Hong Kong on 11 May 2007 at 12 noon, such dividend will be payable on or about 15 June 2007 to shareholders whose names appear on the register of members on 11 May 2007, with a scrip dividend alternative. The register of members will be closed from 8 May 2007 to 11 May 2007, both days inclusive.

To be entitled to receive the final dividend, shareholders must ensure that all transfer documents accompanied by the relevant share certificates are lodged with the Company's registrars, Computershare Hong Kong Investor Services Limited of Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:00 p.m. on Monday, 7 May 2007.

Principal Subsidiaries

Particulars of the principal subsidiaries of the Company are set out on page 146.

Fixed Assets

Movements in fixed assets during the year are set out in note 14 to the Financial Statements.

Capitalised Interest

Interest amounting to HK$9 million was capitalised by the Group during the year as set out in note 4(a) 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 26 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 24 to the Financial Statements.

Charitable Donations

Donations made by the Group for charitable purposes during the year amounted to HK$1,163,900.

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

The Board has reviewed all connected transactions of the Company including the following:

(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 (up to September 2006) and HK$161,560 (from October 2006 onwards) 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, 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 15 March 2007 Bermuda Trust Company Limited ("Bermuda Trust") is deemed to be interested in 54.84% of the issued share capital of the Company and Bermuda Trust is indirectly interested in the said unit trust of which Cobalt is the trustee.

(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 January to December 2006 was HK$8.8 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:

(i) the transaction 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 2006.

Material Related Party Transactions

Details of material related party transactions which were undertaken in the normal course of business are set out in note 34 to the Financial Statements.

Directors

Biographical details of the Directors in office at the date of this report are shown on pages 38 and 39. All the Directors held office for the whole of 2006 with the exception of Messrs. John A. H. Leigh and Nicholas T. J. Colfer who were elected Non-Executive Directors at the Company's Annual General Meeting held on 18 May 2006 to fill the vacancies following the retirement of Sir Sidney Gordon and Mr. James S. Dickson Leach.

In accordance with the articles of association of the Company, The Hon. Sir Michael Kadoorie, Mr. Ian D. Boyce, Mr. Robert C. S. Ng and Mr. Patrick B. Paul will retire by rotation at the forthcoming Annual General Meeting, and being eligible, have agreed to offer themselves for re-election. In addition, Mr. Peter C. Borer was re-elected as a Director at the Company's 2004 Annual General Meeting and will retire voluntarily at the forthcoming Annual General Meeting in accordance with the Company's articles of association, and being eligible, will offer himself for re-election.

None of the Directors to be proposed for re-election at the forthcoming Annual General Meeting has 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

Mr. James S. Dickson Leach ceased to be Alternate Director for The Hon. Sir Michael Kadoorie, Mr. William E. Mocatta and Mr. Ronald J. McAulay following his retirement on 18 May 2006 following the Annual General Meeting.

The Hon. Sir Michael Kadoorie and Mr. William E. Mocatta also ceased to be Alternate Directors following the retirement of Sir Sidney Gordon and Mr. James S. Dickson Leach respectively on 18 May 2006 following the Annual General Meeting.

Senior Management

Biographical details of the senior management at the date of this Report are shown on page 40. They held office for the whole of 2006.

Interests of Directors and Chief Executive

As at 31 December 2006, 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 Issuers (the "Model Code") 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)	712,485,318	49.876
Mr. Ian D. Boyce	Beneficial Owner	206,432	0.015
Mr. Clement K. M. Kwok	Beneficial Owner	619,301	0.043
Mr. Ronald J. McAulay	Note (b)	492,806,747	34.498
Mr. William E. Mocatta	Note (c)	1,017,000	0.071
Dr. The Hon. Sir David K. P. Li	Beneficial Owner	516,081	0.036
Mr. Robert C. S. Ng	Family	121,168	0.009
Mr. Pierre R. Boppe	Beneficial Owner	150,000	0.011
Mr. C. Mark Broadley	Beneficial Owner	206,432	0.015
Mr. Peter C. Borer	Beneficial Owner	116,566	0.008
Mr. John A. H. Leigh	Note (d)	367,191,387	25.704

Notes:

(a) The Hon. Sir Michael Kadoorie was deemed (by virtue of the SFO) to be interested in 712,485,318 shares in the Company. These shares were held in the following capacity:

(i) 421,897,728 shares were ultimately held by discretionary trusts, of which The Hon. Sir Michael Kadoorie is one of the beneficiaries and discretionary objects.

(ii) 290,587,590 shares were ultimately held by a discretionary trust, of which The Hon. Sir Michael Kadoorie is one of the beneficiaries 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 712,485,318 shares referred to in (a). 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) Mr. Ronald J. McAulay was deemed (by virtue of the SFO) to be interested in 492,806,747 shares in the Company. These shares were held in the following capacity:

(i) 421,897,728 shares were ultimately held by discretionary trusts, of which Mr. Ronald J. McAulay is one of the discretionary objects.

(ii) 70,909,019 shares were ultimately held by a discretionary trust, of which Mr. Ronald J. McAulay, his wife and members of his family are discretionary objects.

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

(d) Mr. John A. H. Leigh, in his capacity as one of the trustees of a charitable trust which is one of the ultimate owners of unit trusts which indirectly hold 367,191,387 shares, was deemed to be interested in the 367,191,387 shares.

Messrs. Robert W. Miller, Patrick B. Paul and Nicholas T. J. Colfer, who are Directors of the Company, have each confirmed that they had no interests in the shares of the Company as at 31 December 2006.

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

Except as set out above, as at 31 December 2006 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 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 2006, 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	25,676	0.0018

Interests of Substantial Shareholders

So far as is known to any Director or Chief Executive of the Company, as at 31 December 2006, 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 of the Company

	Capacity	Number of shares held in the Company	% of the issued share capital of the Company
Bermuda Trust Company Limited	Trustee	783,394,337	54.840(i)
The Mikado Private Trust Company Limited	Trustee	712,485,318	49.876(ii)
Bermuda Trust (Cayman) Limited	Trustee	436,508,382	30.557(v)
Acorn Holdings Corporation	Beneficiary	421,897,728	29.534(i)
Lawrencium Holdings Limited	Beneficiary	421,897,728	29.534(i)
Harneys Trustees Limited	Interest of controlled corporation	421,897,728	29.534(v)
Goshawk Investments Limited	Beneficiary	367,191,387	25.704(i)
Guardian Limited	Beneficiary	367,191,387	25.704(i)
Lakshmi Company Limited	Beneficiary	367,191,387	25.704(v)
Merlin Investments Limited	Beneficiary	367,191,387	25.704(v)
Mr. Jason Holroyd Whittle	Beneficiary	367,191,387	25.704(i)
Mrs. Deborah Whittle	Beneficiary	367,191,387	25.704(i)
Mr. Richard Parsons	Trustee	367,191,387	25.704(i)
New Boron Holding Corporation	Trustee	367,191,387	25.704(iii)
New Xenon Holding Corporation	Trustee	367,191,387	25.704(iii)
Lawrencium Mikado Holdings Limited	Beneficiary	290,587,590	20.342(ii)
The Magna Foundation	Beneficiary	290,587,590	20.342 (i)
Mikado Holding Inc.	Trustee	290,587,590	20.342(iv)
Mikado Investments Limited	Interest of controlled corporation/Beneficiary of trusts	290,587,590	20.342(iv)

These interests are duplicated to the extent of 6,881,759,727 shares. The net total of 783,394,337 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 783,394,337 shares in which Bermuda Trust Company Limited was deemed to be interested as a trustee include (1) the 421,897,728 shares in which Acorn Holdings Corporation, Lawrencium Holdings Limited, Goshawk Investments Limited, Guardian Limited, Mr. Jason Holroyd Whittle, Mrs. Deborah Whittle and Mr. Richard Parsons were deemed to be interested; (2) the 290,587,590 shares in which Mikado Investments Limited, The Magna Foundation and Lawrencium Mikado Holdings Limited were deemed to be interested; and (3) the 712,485,318 shares in which The Mikado Private Trust Company Limited was deemed to be interested.

(ii) The Mikado Private Trust Company Limited controlled Lawrencium Holdings Limited and Lawrencium Mikado Holdings Limited and was therefore deemed to be interested in the shares in which such companies were deemed to be interested.

(iii) The 421,897,728 shares in which Acorn Holdings Corporation and Lawrencium Holdings Limited were deemed to be interested as beneficiaries includes the 367,191,387 shares in which New Boron Holding Corporation and New Xenon Holding Corporation were deemed to be interested as trustee.

(iv) The 290,587,590 shares in which Mikado Investments Limited was deemed to be interested as a beneficiary comprises the 290,587,590 shares in which Mikado Holding Inc. as trustee and The Magna Foundation as beneficiary were deemed to be interested.

(v) Harneys Trustees Limited was deemed to be interested in the 367,191,387 shares in which New Boron Holding Corporation and New Xenon Holding Corporation were interested by virtue of having direct control over New Xenon Holding Corporation. Harneys Trustees Limited was also deemed to be interested in another 54,706,341 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. Bermuda Trust (Cayman) Limited controlled Lakshmi Company Limited and Merlin Investments Limited and was therefore deemed to be interested in the shares in which Lakshmi Company Limited and Merlin Investments Limited were interested.

Except as set out above, as at 31 December 2006 the Company had not been notified of any substantial 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.

Interests of any other Persons

As at 31 December 2006, the Company had not been notified of any persons other than the substantial shareholders who had interests or short positions in the shares or underlying shares of the Company, which are required to be recorded in the register required to be kept under Section 336 of Part XV of 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 2006 or at any time during the year.

Employee Retirement Benefits

Details of the Group's employee retirement benefits are shown in note 30 to the Financial Statements.

Corporate Governance

The Corporate Governance Report is set out on pages 65 to 75.

Public Float

As at 15 March 2007, 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 reappointment of KPMG as Auditors will be proposed at the forthcoming Annual General Meeting.

By Order of the Board
Christobelle Liao,
Company Secretary
Hong Kong, 15 March 2007

Financial Statements

Consolidated Income Statement (HK$m)

	Note	Year ended 31 December 2006	2005
Turnover	3	**3,723**	3,276
Cost of inventories		**(283)**	(232)
Staff costs and related expenses		**(1,181)**	(1,028)
Rent and utilities		**(263)**	(261)
Other operating expenses		**(715)**	(663)
Operating profit before depreciation and amortisation ("EBITDA")		**1,281**	1,092
Depreciation and amortisation		**(251)**	(238)
Operating profit		**1,030**	854
Financing charges	4(a)	**(125)**	(163)
Share of loss of jointly controlled entity		**(1)**	(3)
Profit before non-operating items	4	**904**	688
Increase in fair value of investment properties	14(a)	**1,442**	1,089
Reversal of impairment losses, net	14(a)	**200**	117
Net gain on disposal of The Kowloon Hotel	5	**–**	953
Other non-operating items	6	**–**	82
Profit before taxation		**2,546**	2,929
Taxation			
Current tax	7	**(121)**	(118)
Deferred tax	7	**(302)**	(90)
Profit for the year		**2,123**	2,721
Attributable to:			
Shareholders of the Company	26(a)	**2,094**	2,664
Minority interests	26(a)	**29**	57
Profit for the year		**2,123**	2,721
Earnings per share, basic and diluted (HK$)	11	**1.47**	1.89
Dividends per share (HK cents)		**16**	14
Dividends payable to shareholders of the Company attributable to the year:	12(a)		
Interim dividend declared during the year		**71**	57
Final dividend proposed after the balance sheet date		**157**	142
		228	199

The notes on pages 91 to 147 form part of these Financial Statements.

Consolidated Balance Sheet (HK$m)

	Note	At 31 December 2006	2005
Non-current assets			
Fixed assets			
Properties, plant and equipment		**5,223**	4,406
Investment properties		**17,728**	16,155
	14	**22,951**	20,561
Interest in jointly controlled entity	16	**470**	446
Investment in hotel management contract		**163**	168
Interests in unlisted equity instruments	17	**52**	52
Derivative financial instruments	18(a)	**28**	23
Deferred tax assets	19(b)	**98**	123
		23,762	21,373
Current assets			
Inventories	20	**86**	77
Debtors and payments in advance	21	**308**	216
Taxation recoverable	19(a)	**3**	3
Derivative financial instruments	18(a)	**3**	2
Cash and cash equivalents	22	**447**	301
		847	599
Current liabilities			
Creditors and accruals	23	**(1,111)**	(865)
Interest-bearing borrowings	24	**(306)**	(139)
Derivative financial instruments	18(a)	**(8)**	(5)
Current taxation	19(a)	**(93)**	(78)
		(1,518)	(1,087)
Net current liabilities		**(671)**	(488)
Total assets less current liabilities		**23,091**	20,885
Non-current liabilities			
Interest-bearing borrowings	24	**(2,217)**	(2,475)
Net defined benefit retirement obligation	30(a)	**(23)**	(23)
Derivative financial instruments	18(a)	**(206)**	(204)
Deferred tax liabilities	19(b)	**(2,880)**	(2,577)
		(5,326)	(5,279)
Net assets		**17,765**	15,606
Capital and reserves			
Share capital	25	**714**	709
Reserves	26(a)	**16,268**	14,187
Total equity attributable to shareholders of the Company		**16,982**	14,896
Minority interests	26(a)	**783**	710
Total equity		**17,765**	15,606

Approved by the Board of Directors on 15 March 2007 and signed on its behalf by:

The Hon. Sir Michael Kadoorie, Clement K. M. Kwok, C. Mark Broadley, *Directors*

Consolidated Cash Flow Statement (HK$m)

	Note	Year ended 31 December 2006	2005
Operating activities			
Profit before non-operating items		**904**	688
Adjustments for:			
Depreciation		**246**	231
Amortisation			
– land lease premium		**–**	1
– hotel management contract		**5**	6
Financing charges		**125**	163
Dividend income from unlisted equity instruments		**–**	(3)
Interest income		**(6)**	(4)
Share of loss of jointly controlled entity		**1**	3
Loss on disposal of fixed assets		**6**	9
Foreign exchange gain		**–**	(8)
Operating profit before changes in working capital		**1,281**	1,086
(Increase)/decrease in inventories		**(7)**	1
Increase in debtors and payments in advance		**(90)**	(2)
Increase in creditors and accruals		**87**	54
Cash generated from operations		**1,271**	1,139
Net tax paid:			
Hong Kong Profits Tax paid		**(28)**	(35)
Overseas tax paid		**(79)**	(46)
Net cash from operating activities		**1,164**	1,058
Investing activities			
Purchase of fixed assets		**(631)**	(344)
Capital injected/loan granted to jointly controlled entity		**(14)**	(308)
Interest received		**6**	4
Acquisition of subsidiary, net of cash acquired	28	**–**	(2)
Receipt in relation to the disposal of a subsidiary	28	**–**	1,684
Dividend received from unlisted equity instruments		**–**	3
Proceeds from sale of fixed assets		**2**	152
Net cash (used in)/generated from investing activities		**(637)**	1,189
Financing activities			
Drawdown of bank loans		**778**	836
Repayment of bank loans		**(392)**	(2,488)
Net decrease of revolving credits		**(477)**	(234)
Dividends paid to shareholders of the Company		**(108)**	(104)
Interest paid and other financing charges		**(184)**	(210)
Dividends paid to minority shareholders		**(3)**	(5)
Net cash used in financing activities		**(386)**	(2,205)
Net increase in cash and cash equivalents		**141**	42
Cash and cash equivalents at 1 January		**285**	243
Effect of changes in foreign exchange rates		**7**	–
Cash and cash equivalents at 31 December	22	**433**	285

The notes on pages 91 to 147 form part of these Financial Statements.

Parent Company Balance Sheet (HK$m)

	Note	At 31 December 2006	2005
Non-current assets			
Investments in subsidiaries	15	**94**	71
Derivative financial instruments	18(b)	**137**	149
Deferred tax asset	19(b)	**5**	10
		236	230
Current assets			
Debtors and payments in advance	21	**11,153**	10,173
Derivative financial instruments	18(b)	**4**	3
Cash and cash equivalents	22	**5**	7
		11,162	10,183
Current liabilities			
Creditors and accruals	23	**(15)**	(20)
Derivative financial instruments	18(b)	**(7)**	(5)
Current taxation	19(a)	**(38)**	(22)
		(60)	(47)
Net current assets		**11,102**	10,136
Non-current liability			
Derivative financial instruments	18(b)	**(162)**	(203)
Net assets		**11,176**	10,163
Capital and reserves			
Share capital	25	**714**	709
Reserves	26(b)	**10,462**	9,454
Total equity		**11,176**	10,163

Approved by the Board of Directors on 15 March 2007 and signed on its behalf by:

The Hon. Sir Michael Kadoorie, Clement K. M. Kwok, C. Mark Broadley, *Directors*

The notes on pages 91 to 147 form part of these Financial Statements.

Consolidated Statement of Changes in Equity (HK$m)

	Year ended 31 December			
		2006		2005
Total equity at 1 January				
Attributable to equity shareholders of the Company	**14,896**		12,342	
Minority interests	**710**		614	
	15,606		12,956	
Opening balance adjustments arising from the initial adoption of HKAS 32 and 39	**–**		(304)	
At 1 January, after opening balance adjustments		**15,606**		12,652
Net income for the year recognised directly in equity:				
Exchange differences on translation of financial statements of foreign entities		**152**		6
Cash flow hedges: effective portion of changes in fair value, net of tax		**(29)**		50
Net income for the year recognised directly in equity		**123**		56
Cash flow hedges:				
transfer from equity to profit or loss, net of tax		**20**		214
transfer from equity to fixed assets, net of tax		**4**		–
Net profit for the year		**2,123**		2,721
Total recognised income for the year		**2,270**		2,991
Attributable to:				
Shareholders of the Company	**2,194**		2,930	
Minority interests	**76**		61	
	2,270		2,991	
Dividends				
Distributed to shareholders of the Company:				
– by means of cash	**(108)**		(104)	
– by means of scrip	**(105)**		(79)	
Paid in cash to minority interests	**(3)**		(5)	
		(216)		(188)
Issuance of new shares		**105**		111
Minority interests arising from business combination		**–**		40
Total equity at 31 December		**17,765**		15,606

The notes on pages 91 to 147 form part of these Financial Statements.

Notes to the Financial Statements

1. Significant accounting policies

(a) Statement of compliance

These Financial Statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRS"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These Financial Statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRS that are effective or available for early adoption for the current accounting period of the Group and the Company. Note 2 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these Financial Statements. The adoption of these new and revised HKFRS has not resulted in any significant impact on the Group's results of operations and financial position for the current accounting period.

(b) Basis of preparation of the Financial Statements

The consolidated Financial Statements for the year ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the 'Group') and the Group's interest in a jointly controlled entity.

The measurement basis used in the preparation of the Financial Statements is the historical cost basis except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

i) investment property (see note 1(j));
ii) other leasehold land and buildings, for which the fair values cannot be measured separately at the inception of the lease and the entire lease is classified as a finance lease (see notes 1(i) and (l));
iii) financial instruments classified as available-for-sale securities (see note 1(f)); and
iv) derivative financial instruments (see note 1(g)).

The preparation of Financial Statements in conformity with HKFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revision to accounting estimates is recognised in the period in which the estimates are revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRS that may have a significant effect on the Financial Statements and estimates are discussed in note 36.

(c) Subsidiaries and minority interest

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

1. Significant accounting policies *continued*

(c) Subsidiaries and minority interest *continued*

An investment in a subsidiary is consolidated into the consolidated Financial Statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated Financial Statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Company, whether directly or indirectly through subsidiaries and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the shareholders of the Company.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses (see note 1(m)), unless the investment is classified as held for sale.

(d) Jointly controlled entities

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or Company and other parties, where the contractual arrangement establishes that the Group or Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in a jointly controlled entity is accounted for in the consolidated Financial Statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the jointly controlled entity's net assets. The consolidated income statement includes the Group's share of the post-acquisition, post-tax results of the jointly controlled entities for the year, including any impairment loss on goodwill relating to the investment in jointly controlled entities recognised for the year (see notes 1(e) and (m)).

When the Group's share of losses exceeds its interest in the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the jointly controlled entity. For this purpose, the Group's interest in the jointly controlled entity is the carrying amount of the investment under the equity method, together with the Group's long-term interests that in substance form part of the Group's net investment in the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its jointly controlled entities are eliminated to the extent of the Group's interest in the jointly controlled entity, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Company's balance sheet, its investments in jointly controlled entities are stated at cost less impairment losses (see note 1(m)).

(e) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 1(m)). In respect of a jointly controlled entity, the carrying amount of goodwill is included in the carrying amount of the interest in the jointly controlled entity.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in a jointly controlled entity is recognised immediately in profit or loss.

On disposal of a cash generating unit or a jointly controlled entity during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

(f) Equity instruments

The Group's long term investments which are equity in nature (other than investments in subsidiaries, associates and jointly controlled entities) that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are classified as interests in equity instruments and recognised in the balance sheet at cost less impairment losses (see note 1(m)).

Interests in equity instruments are recognised/derecognised on the date the Group commits to purchase/sell the investments.

(g) Derivative financial instruments

Derivative financial instruments are recognised initially at fair value. At each balance sheet date the fair value is remeasured. The gain or loss on remeasurement to fair value is charged immediately to profit or loss, except where the derivatives qualify for cash flow hedge accounting or hedge the net investment in a foreign operation, in which case recognition of any resultant gain or loss depends on the nature of the item being hedged (see note 1(h)).

(h) Hedging

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecast transaction or the foreign currency risk of a committed future transaction, the effective portion of any gain or loss on remeasurement of the derivative financial instrument to fair value is recognised directly in equity. The ineffective portion of any gain or loss is recognised immediately in profit or loss.

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gain or loss is removed from equity and recognised in profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss (such as when interest income or expense is recognised).

For cash flow hedges, other than those covered by the preceding two policy statements, the associated gain or loss is removed from equity and recognised in profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss.

1. Significant accounting policies *continued*

(h) Hedging *continued*

Cash flow hedges *continued*

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in profit or loss.

Hedge of net investments in foreign operations

The portion of the gain or loss on remeasurement to fair value of an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity until the disposal of the foreign operation, at which time the cumulative gain or loss recognised directly in equity is recognised in profit or loss. The ineffective portion is recognised immediately in profit or loss.

(i) Properties, plant and equipment

Hotel and other properties held for own use, and plant and equipment are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 1 (m)).

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs (see note 1(x)).

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the carrying values of the assets on a straight line basis over the shorter of the unexpired period of the land lease and the anticipated remaining useful lives of the assets. The useful lives which have been adopted are summarised as follows:

◆ hotel buildings	75 to 150 years
◆ other buildings	50 years
◆ golf courses	100 years
◆ external wall finishes, windows, roofing and glazing works	10 to 40 years
◆ major plant and machinery	15 to 25 years
◆ furniture, fixtures and equipment	3 to 20 years
◆ operating equipment	3 to 5 years
◆ motor vehicles	5 to 10 years

No depreciation is provided on freehold land as it is deemed to have an indefinite life.

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

(j) Investment properties

Investment properties are land and/or buildings which are owned or held under a leasehold interest (see note 1(l)) to earn rental income and/or for capital appreciation. These include land held for currently undetermined future use.

Investment properties are stated in the balance sheet at fair value. Any gain or loss arising from a change in fair value or from the retirement or disposal of an investment property is recognised in profit or loss. Rental income from investment properties is accounted for as described in note 1(v).

When the Group holds a property interest under an operating lease to earn rental income and/or for capital appreciation, the interest is classified and accounted for as an investment property on a property-by-property basis. Any such property interest which has been classified as an investment property is accounted for as if it were held under a finance lease (see note 1(l)), and the same accounting policies are applied to that interest as are applied to other investment properties leased under finance leases. Lease payments are accounted for as described in note 1(l).

Property that is being constructed or developed for future use as investment property is classified as property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property at fair value. Any difference between the fair value of the property at that date and its previous carrying amount is recognised in profit or loss.

(k) Investment in hotel management contract

Payments for acquiring hotel management contracts are capitalised and are stated in the balance sheet at cost less accumulated amortisation and impairment losses (see note 1(m)).

Amortisation of investment in hotel management contracts is charged to profit or loss on a straight-line basis over the term of the relevant agreements.

(l) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal from of a lease.

Classification of assets leased to the Group

Assets that are held by the Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases, with the following exceptions:

- property held under operating leases that would otherwise meet the definition of an investment property is classified as an investment property on a property-by-property basis and, if classified as investment property, is accounted for as if held under a finance lease (see note 1(j)); and
- land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease, unless the building is also clearly held under an operating lease. For these purposes, the inception of the lease is the time that the lease was first entered into by the Group, or taken over from the previous lessee.

1. Significant accounting policies *continued*

(l) Leased assets *continued*

Assets acquired under finance leases

Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 1(i). Impairment losses are accounted for in accordance with the accounting policy as set out in note 1(m). Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to income statement in the accounting period in which they are incurred.

Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term except where the property is classified as an investment property.

(m) Impairment of assets

Impairment of financial assets

Financial assets include loans granted by the Group or Company other than those regarded as long-term interests that in substance form part of the Group's net investments in the jointly controlled entities, interests in unlisted equity instruments, and debtors (including trade debtors and receivables from related parties).

Financial assets that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is determined and recognised as follows:

- For unquoted equity instruments carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for equity instruments are not reversed.
- For financial assets carried at amortised cost (such as loans), the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of the asset); where the effect of discounting is material. If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

1. Significant accounting policies *continued*

(m) Impairment of assets *continued*

Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- Hotel and other properties, plant and equipment;
- pre-paid interests in leasehold land classified as being held under an operating lease;
- investment in hotel management contracts;
- interests in subsidiaries and jointly controlled entities; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. For goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

- Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

  An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or a cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of a cash-generating unit are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

- Reversals of impairment losses

  In respect of assets other than goodwill, an impairment loss is reversed if the recoverable amount of an asset, or the cash-generating unit to which it belongs, exceeds its carrying amount. An impairment loss in respect of goodwill is not reversed.

  A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

- Interim financial reporting and impairment

  Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS 34, Interim financial reporting, in respect of the first six months of the financial year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the financial year.

  Impairment losses recognised in an interim period in respect of goodwill and unquoted equity instruments carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the financial year to which the interim period relates.

1. Significant accounting policies *continued*

(n) Inventories

Land lots for sale and other inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

(o) Trade debtors and other receivables

Trade debtors and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 1(m)), except where they are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, they are stated at cost less impairment losses for bad and doubtful debts (see note 1(m)).

(p) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

(q) Trade creditors and other payables

Trade creditors and other payables are initially recognised at fair value. Except for financial guarantee liabilities measured in accordance with note 1(u), trade and other payables are subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(r) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

(s) Employee benefits

Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(s) Employee benefits *continued*

Defined benefit retirement plan obligations

The Group's net obligation in respect of defined benefit retirement plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on high quality corporate bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in profit or loss on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately, the expense is recognised immediately in profit or loss.

In calculating the Group's obligation in respect of a plan, if any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in profit or loss over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation of the Group's net obligation results in a negative amount, the asset recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(t) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the assets can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax losses or credits can be utilised.

1. Significant accounting policies *continued*

(t) Income tax *continued*

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(u) Provisions, contingent liabilities and financial guarantees issued

Provisions are recognised for liabilities of uncertain timing or amount when the Group or Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

Financial guarantees are contracts that require the issuer (i.e. the guarantor) to make specified payments to reimburse the beneficiary of the guarantee (the "holder") for a loss the holder incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

1. Significant accounting policies *continued*

(u) Provisions, contingent liabilities and financial guarantees issued *continued*

Where the Group issues a financial guarantee, where material, the fair value of the guarantee (being the transaction price, unless the fair value can otherwise be reliably estimated) is initially recognised as deferred income within trade and other payables. Where consideration is received or receivable for the issuance of the guarantee, the consideration is recognised in accordance with the Group's policies applicable to that category of asset. Where no such consideration is received or receivable, an immediate expense is recognised in the income statement on initial recognition of any deferred income.

The amount of the guarantee initially recognised as deferred income is amortised in the income statement over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised if and when (i) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (ii) the amount of that claim on the Group is expected to exceed the amount currently carried in trade and other payables in respect of that guarantee i.e. the amount initially recognised, less accumulated amortisation.

Contingent liabilities acquired as part of a business combination are initially recognised at fair value, provided the fair value can be reliably measured. After their initial recognition at fair value, such contingent liabilities are recognised at the higher of the amount initially recognised, less accumulated amortisation where appropriate, and the amount that would be determined in accordance with the first paragraph of this note. Contingent liabilities acquired in a business combination that cannot be reliably fair valued are disclosed in accordance with the second paragraph of this note.

(v) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group or Company and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

Hotel and Golf Club operations

Revenue is recognised on a basis that reflects the timing, nature and value when the relevant services are provided.

Sale of land lots

Revenue is recognised upon the transfer of legal title of the land lots. Deposits and instalments received on land lots sold prior to the date of revenue recognition are included in the balance sheet under creditors.

Sale of goods and wholesaling

Revenue is recognised when goods are delivered and the related risks and rewards of ownership of the goods have been transferred to the customers. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

Rental income from operating leases

Rental income receivable under operating leases is recognised in profit or loss in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in profit or loss as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

Dividends

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

Interest income

Interest income is recognised as it accrues using the effective interest method.

1. Significant accounting policies *continued*

(w) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss, except those arising from foreign currency borrowings used to hedge a net investment in a foreign operation which are recognised directly in equity (see note 1(h)).

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

On disposal of a foreign operation, the cumulative amount of the exchange differences recognised in equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

(x) Borrowing costs

Borrowing costs are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to become ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(y) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

- i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- ii) the Group and the party are subject to common control;
- iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;
- iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

1. Significant accounting policies *continued*

(z) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade debtors and fixed assets. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing borrowings, tax balances, and corporate and financing expenses.

2. Changes in accounting policies

The HKICPA has issued certain new and revised HKFRS that are first effective or available for early adoption for the current accounting period of the Group. The adoption of these new and revised HKFRS has not resulted in any significant impact on the Group's operations results for the year and financial position as at 31 December 2006.

Note 1 summarises the accounting policies of the Group after the adoption of these new and revised HKFRS to the extent that they are relevant to the Group.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 37).

In prior years, financial guarantees issued by the Group were disclosed as contingent liabilities in accordance with HKFRS 4, *Insurance contracts* and HKAS 37, *Provisions*, *contingent liabilities* and *contingent assets*. No provisions were made in respect of these guarantees unless it was more likely than not that the guarantee would be called upon.

With effect from 1 January 2006, in order to comply with the amendments to HKAS 39 in respect of financial guarantee contracts, the Group has changed its accounting policy for financial guarantees issued. Under the new policy, financial guarantees issued are accounted for as financial liabilities under HKAS 39 and measured initially at fair value, where material and the fair value can be reliably measured. Subsequently, they are measured at the higher of the amount initially recognised, less accumulated amortisation, and the amount of the provision, if any, that should be recognised in accordance with HKAS 37. Further details of the new policy are set out in note 1(u).

The adoption of these amendments does not have a significant impact on the Group's results of operations and financial position for financial years 2005 and 2006.

3. Turnover (HK$m)

The Company is an investment holding company. The Group is principally engaged in the ownership and management of prestigious hotel, commercial and residential properties.

Turnover represents the gross amount invoiced for services, inventories and facilities including management fees and rental income. The amount of each significant category of revenue recognised in turnover during the year is as follows:

	2006	2005
Hotels		
Rooms	**1,455**	1,297
Food and beverage	**813**	735
Commercial rentals	**407**	377
Others	**275**	257
	2,950	2,666
Rentals from non-hotel properties	**464**	374
Other businesses	**309**	236
	3,723	3,276

4. Profit before non-operating items (HK$m)

Profit before non-operating items is arrived at after charging/(crediting):

(a) Financing charges

	2006	2005
Interest on bank borrowings wholly repayable within five years	**115**	106
Interest on bank borrowings repayable after five years	**–**	7
Derivative financial instruments:		
cash flow hedges, transfer from equity	**10**	43
Other borrowing costs	**9**	15
	134	171
Less: Amount capitalised into assets under development*	**(9)**	(8)
	125	163

* *The average rate used for capitalisation was **2.3%** (2005: 1.9%).*

4. Profit before non-operating items (HK$m) *continued*

(b) Other items

	2006	2005
Amortisation		
– land lease premium	**–**	1
– hotel management contract	**5**	6
Depreciation	**246**	231
Auditors' remuneration		
– audit services	**7**	7
– tax	**1**	1
Foreign exchange gains	**1**	1
Operating lease charges: minimum lease payments		
– hire of other assets (including property rentals)	**76**	69
Rental receivable from investment properties less direct outgoings of **HK$21 million** (2005: HK$27 million)	**(796)**	(645)
Dividend income from unlisted equity instruments	**–**	(3)
Interest income	**(6)**	(4)

5. Net gain on disposal of the Kowloon Hotel (HK$m)

	2006	2005
Gain on disposal of The Kowloon Hotel (note 28)	**–**	1,171
Fair value changes of related derivative financial instruments	**–**	(218)
	–	953

Due to the reduction of bank borrowings following the completion of the sale of The Kowloon Hotel, the loan interest hedging ratio was re-adjusted in 2005 by way of offsetting swap arrangements rendering some interest rate swap contracts ineffective, which gave rise to a one-off loss of HK$218 million in 2005.

6. Other non-operating items (HK$m)

	2006	2005
Gain on disposal of investment property	**–**	60
Others	**–**	22
	–	82

7. Income tax in the consolidated income statement (HK$m)

(a) Taxation in the consolidated income statement represents:

	2006	2005
Current tax – Hong Kong Profits Tax		
Provision for the year	**58**	38
Under-provision in respect of prior years	**1**	–
	59	38
Current tax – Overseas		
Provision for the year	**59**	80
Under-provision in respect of prior years	**3**	–
	62	80
	121	118
Deferred tax		
Increase in net deferred tax liabilities relating to revaluation of investment properties in:		
– Hong Kong*	**230**	169
– Overseas	**19**	(5)
Increase/(decrease) in net deferred tax liabilities relating to other temporary differences	**44**	(45)
Transfer to/(from) hedging reserve	**9**	(29)
Origination and reversal of temporary differences	**302**	90
	423	208

The above tax expenses include **HK$305 million** (2005: HK$173 million) in respect of fair value change of investment properties and non-operating items.

The provision for Hong Kong Profits Tax for 2006 is calculated at **17.5%** (2005: 17.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant jurisdictions.

* *The Directors have no intention of selling the Group's investment properties in Hong Kong, and consider that should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in Hong Kong.*

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2006	2005
Profit before taxation	**2,546**	2,929
Notional tax at the domestic income tax rate of 17.5%	**446**	513
Tax effect of non-deductible expenses	**21**	3
Tax effect of non-taxable income	**(20)**	(207)
Tax effect of utilisation of tax losses	**(30)**	(54)
Tax effect of unused tax losses not recognised	**9**	5
Write off of tax losses expired	**–**	6
Recognition of prior years' tax losses	**(43)**	(110)
Effect of different tax rates of subsidiaries operating in other jurisdictions	**38**	61
Others	**2**	(9)
Actual tax expense	**423**	208

8. Directors' and senior management's remuneration

There are three components of remuneration paid to Executive Directors, as well as senior management and other staff.

Basic compensation
Basic compensation consists of base salary, housing and other allowances and benefits. Basic compensation is reviewed annually, taking into account market conditions and individual performance.

Bonuses and incentives
Bonus payments depend on individual performance and the performance of the Group. In addition, certain incentive payments have been defined in the individual employment contracts.

Retirement benefits
Retirement benefits relate to the Group's contribution to retirement funds.

For Non-Executive Directors, fees are set in line with market practice, taking account of comparable Hong Kong listed companies, and at present are fixed at HK$100,000 per annum. Non-Executive Directors who are also members of the Executive Committee or the Audit Committee are also entitled to a fixed fee of HK$100,000 per annum for each committee.

Remuneration for Directors disclosed pursuant to section 161 of the Hong Kong Companies Ordinance and that for senior management disclosed pursuant to corporate governance best practice are as follows:

	Directors' fees (HK$'000)	Basic compensation (HK$'000)	Bonuses & incentives (HK$'000)	Retirement benefits (HK$'000)	Total (HK$'000)
2006					
*Executive Directors**					
Mr. Clement K. M. Kwok	–	4,342	4,719	671	9,732
Mr. C. Mark Broadley	–	3,657	2,776	556	6,989
Mr. Peter C. Borer	–	3,161	1,701	464	5,326
Non-Executive Directors					
The Hon. Sir Michael Kadoorie	200	–	–	–	200
Mr. Ian D. Boyce	300	–	–	–	300
Mr. James S. Dickson Leach**	76	–	–	–	76
Sir Sidney Gordon**	38	–	–	–	38
Mr. Ronald J. McAulay	100	–	–	–	100
Mr. William E. Mocatta	100	–	–	–	100
Mr. Pierre R. Boppe	100	–	–	–	100
Mr. John A. H. Leigh***	124	–	–	–	124
Mr. Nicholas T. J. Colfer***	62	–	–	–	62
Independent Non-Executive Directors					
Dr. The Hon. Sir David K. P. Li	100	–	–	–	100
Mr. Robert C. S. Ng	200	–	–	–	200
Mr. Robert W. Miller	100	–	–	–	100
Mr. Patrick B. Paul	200	–	–	–	200
Senior management (other members of Group Management Committee)*					
Mr. J. Niklaus Leuenberger	–	3,571	395	135	4,101
Mr. Martyn P. A. Sawyer	–	2,805	445	272	3,522
	1,700	**17,536**	**10,036**	**2,098**	**31,370**

8. Directors' and senior management's remuneration *continued*

	Directors' fees (HK$'000)	Basic compensation (HK$'000)	Bonuses & incentives (HK$'000)	Retirement benefits (HK$'000)	Total (HK$'000)
2005					
*Executive Directors**					
Mr. Clement K. M. Kwok	–	4,289	5,189	651	10,129
Mr. C. Mark Broadley	–	3,579	2,001	540	6,120
Mr. Peter C. Borer	–	3,098	1,095	450	4,643
Non-Executive Directors					
The Hon. Sir Michael Kadoorie	200	–	–	–	200
Mr. Ian D. Boyce	300	–	–	–	300
Mr. James S. Dickson Leach**	200	–	–	–	200
Sir Sidney Gordon**	100	–	–	–	100
Mr. Ronald J. McAulay	100	–	–	–	100
Mr. William E. Mocatta	100	–	–	–	100
Mr. Pierre R. Boppe	100	–	–	–	100
Independent Non-Executive Directors					
Dr. The Hon. Sir David K. P. Li	100	–	–	–	100
Mr. Robert C. S. Ng	200	–	–	–	200
Mr. Robert W. Miller	100	–	–	–	100
Mr. Patrick B. Paul	200	–	–	–	200
Senior management (other members of Group Management Committee)*					
Mr. J. Niklaus Leuenberger	–	3,394	502	187	4,083
Mr. Martyn P. A. Sawyer	–	2,743	353	268	3,364
	1,700	17,103	9,140	2,096	30,039

* *The Group Management Committee, the Company's management and operations' decision-making authority, is comprised of the three Executive Directors and two senior executives who represent the various key functions and operations of the Company.*

** *Mr. James S. Dickson Leach and Sir Sidney Gordon retired as Non-Executive Directors of the Company on 18 May 2006.*

*** *Messrs John A. H. Leigh and Nicholas T. J. Colfer were elected as Non-Executive Directors of the Company on 18 May 2006.*

9. Individuals with highest emoluments (HK$m)

Of the five individuals with the highest emoluments, **three** (2005: three) are directors whose emoluments are disclosed in note 8. The aggregate of the emoluments in respect of the other **two** (2005: two) individuals are as follows:

	2006	2005
Basic compensation	**6**	6
Bonuses & incentives	**1**	1
Retirement benefits	**–**	–
	7	7

The emoluments of the other **two** (2005: two) individuals with the highest emoluments are within the following bands:

	2006 Number	2005 Number
HK$3,000,001 – HK$3,500,000	**–**	1
HK$3,500,001 – HK$4,000,000	**1**	–
HK$4,000,001 – HK$4,500,000	**1**	1
	2	2

10. Profit attributable to shareholders of the company (HK$m)

The consolidated profit attributable to shareholders of the Company includes a profit of **HK$276 million** (2005: HK$550 million) which has been dealt with in the financial statements of the Company.

Reconciliation of the above amount to the Company's profit for the year:

	2006	2005
Amount of consolidated profit attributable to shareholders dealt with in the financial statements of the Company	**276**	550
Reversal of provision for impairment for interests in subsidiaries	**822**	120
Company's profit for the year	**1,098**	670

As at 31 December 2006, the Directors considered that, due to the significant improvement in the operating performance of the subsidiaries and in the property market, the provision for impairment previously made against the interests in subsidiaries should be reversed by **HK$822 million** (2005: HK$120 million).

11. Earnings per share

(a) Earnings per share – basic

	2006	2005
Profit attributable to shareholders of the Company (HK$m)	**2,094**	2,664
Weighted average number of shares in issue (million shares)*	**1,421**	1,411
Earnings per share (HK$)	**1.47**	1.89

* *Weighted average number of shares* (million)

	2006	2005
Issued shares at 1 January	**1,417**	1,402
Effect of new shares issued and allotted as part consideration to acquire a subsidiary (note 27)	**–**	4
Effect of new shares issued and allotted to shareholders who opted to take scrip as an alternative to cash in respect of the 2005 final and 2006 interim dividends	**4**	5
Weighted average number of shares at 31 December	**1,421**	1,411

(b) Earnings per share – diluted

There were no potential dilutive ordinary shares in existence during the years ended 31 December 2006 and 2005, and hence the diluted earnings per share is the same as the basic earnings per share.

12. Dividends (HK$m)

(a) Dividends payable to shareholders of the Company attributable to the year

	2006	2005
Interim dividend declared and paid of **5 cents** per share (2005: 4 cents per share)	**71**	57
Final dividend proposed after the balance sheet date of **11 cents** per share (2005: 10 cents per share)	**157**	142
	228	199

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends payable to shareholders of the Company attributable to the previous financial year, approved and paid during the year

	2006	2005
Final dividend in respect of the previous financial year, approved and paid during the year, of **10 cents** per share (2005: 9 cents per share)	**142**	126

13. Segment reporting (HK$m)

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group in making operating and financial decisions. The revenue and operating performance of the Group's hotel business segment are subject to a higher degree of seasonal volatility by nature whilst those for the Group's property leasing segment are subject to a relatively lower degree of seasonality.

(a) Business segments

The Group is comprised of the following main business segments:

Hotels	Hotel room accommodation, leasing of commercial shopping arcades and office premises, provision of food and beverage at restaurant outlets, operation of retail outlets and other minor departments such as spa, telephone, guest transportation and laundry within the hotel premises.
Rentals from non-hotel properties	Leasing of commercial and office premises (other than those in hotel properties) and residential apartments.
Other businesses	Various other businesses including operation of golf courses, The Peak Tramways, food and beverage outlets other than those in owned hotels, wholesaling of food and beverage products, laundry, and provision of management and consultancy services for clubs.

	Hotels		Rentals from non-hotel properties		Other businesses		Consolidated	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
Segment turnover and results – for the year ended 31 December								
Turnover								
Total segment	**2,951**	2,667	**468**	375	**322**	255	**3,741**	3,297
Inter-segment	**(1)**	(1)	**(4)**	(1)	**(13)**	(19)	**(18)**	(21)
	2,950*	2,666	**464**	374	**309**	236	**3,723**	3,276
Segment operating profit before depreciation and amortisation	**882**	769	**328**	263	**71**	60	**1,281**	1,092
Depreciation and amortisation	**(229)**	(213)	**–**	–	**(22)**	(25)	**(251)**	(238)
Segment operating profit	**653**	556	**328**	263	**49**	35	**1,030**	854
Financing charges							**(125)**	(163)
Share of loss of jointly controlled entity	**(1)**	(3)	**–**	–	**–**	–	**(1)**	(3)
Profit before non-operating items							**904**	688
Increase in fair value of investment properties	**582**	585	**859**	488	**1**	16	**1,442**	1,089
Reversal of impairment losses, net	**210**	148	**–**	–	**(10)**	(31)	**200**	117
Net gain on disposal of The Kowloon Hotel							**–**	953
Other non-operating items							**–**	82
Profit before taxation							**2,546**	2,929
Taxation							**(423)**	(208)
Profit for the year							**2,123**	2,721

13. Segment reporting (HK$m) *continued*

(a) Business segments *continued*

	Hotels		Rentals from non-hotel properties		Other businesses		Consolidated	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
Segment balance sheet – as at 31 December								
Properties, plant and equipment	**4,876**	4,086	**–**	–	**347**	320	**5,223**	4,406
Investment properties	**6,695**	6,142	**10,639**	9,646	**394**	367	**17,728**	16,155
Interest in jointly controlled entity	**470**	446	**–**	–	**–**	–	**470**	446
Investment in hotel management contract	**163**	168	**–**	–	**–**	–	**163**	168
Interests in unlisted equity instruments	**43**	43	**–**	–	**9**	9	**52**	52
Other segment assets	**303**	232	**33**	21	**58**	40	**394**	293
Derivative financial instruments							**31**	25
Taxation recoverable							**3**	3
Deferred tax assets							**98**	123
Cash and cash equivalents							**447**	301
Total assets							**24,609**	21,972
Liabilities								
Segment liabilities	**735**	639	**209**	185	**190**	64	**1,134**	888
Bank loans and other liabilities							**5,710**	5,478
Total liabilities							**6,844**	6,366
Capital expenditure incurred during the year	**618**	626	**132**	136	**23**	33	**773**	795

* ***Analysis of hotels' turnover***

	2006	2005
Rooms	**1,455**	1,297
Food and beverage	**813**	735
Commercial	**407**	377
Others	**275**	257
	2,950	2,666

(b) Geographical segments

The Group's hotel operations and property rental businesses are principally located in Hong Kong, the People's Republic of China, Thailand, the Philippines, Vietnam and the United States of America. The golf course operations are located in Thailand and the United States of America. Other miscellaneous businesses are mostly conducted in Hong Kong.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location in which the business operation is conducted. Segment assets and capital expenditure are based on the geographical location of the assets.

	Hong Kong		Other Asia		United States of America	
	2006	2005	**2006**	2005	**2006**	2005
For the year ended 31 December						
Revenue from external customers	**1,636**	1,411	**887**	777	**1,200**	1,088
Segment assets	**17,066**	15,442	**4,168**	3,494	**2,796**	2,584
Capital expenditure incurred during the year	**266**	197	**438**	562	**69**	36
Depreciation and amortisation	**56**	54	**92**	77	**103**	107

14. Fixed assets

(a) Movements of fixed assets (HK$m)

	Freehold land	Hotel and other buildings held for own use	Plant, machinery and other fixed assets	Sub-total	Investment properties	Interests in leasehold land held under operating leases	Total fixed assets
Cost or valuation:							
At 1 January 2005	881	4,978	3,108	8,967	15,478	376	24,821
Exchange adjustments	(29)	(52)	(29)	(110)	(8)	–	(118)
Additions							
– through acquisition of subsidiary	–	340	72	412	8	–	420
– others	–	50	191	241	134	–	375
Disposals							
– through disposal of subsidiary	–	(45)	(211)	(256)	(452)	(375)	(1,083)
– others	–	–	(86)	(86)	(94)	–	(180)
Fair value adjustment	–	–	–	–	1,089	–	1,089
At 31 December 2005	852	5,271	3,045	9,168	16,155	1	25,324
Representing:							
Cost	852	5,271	3,045	9,168	–	1	9,169
Valuation – 2005	–	–	–	–	16,155	–	16,155
	852	5,271	3,045	9,168	16,155	1	25,324
At 1 January 2006	852	5,271	3,045	9,168	16,155	1	25,324
Exchange adjustments	74	240	51	365	72	–	437
Additions	–	86	564	650	123	–	773
Disposals	–	(20)	(28)	(48)	(2)	–	(50)
Transfer	–	62	–	62	(62)	–	–
Fair value adjustment	–	–	–	–	1,442	–	1,442
At 31 December 2006	926	5,639	3,632	10,197	17,728	1	27,926
Representing:							
Cost	926	5,639	3,632	10,197	–	1	10,198
Valuation – 2006	–	–	–	–	17,728	–	17,728
	926	5,639	3,632	10,197	17,728	1	27,926
Accumulated depreciation:							
At 1 January 2005	339	2,192	2,098	4,629	–	134	4,763
Exchange adjustments	(14)	(34)	(4)	(52)	–	–	(52)
Through acquisition of subsidiary	–	173	63	236	–	–	236
Charge for the year	–	100	131	231	–	1	232
Provision for/(reversal of) impairment losses	19	(15)	18	22	–	–	22
Written back on disposals							
– through disposal of subsidiary	–	(37)	(196)	(233)	–	(134)	(367)
– others	–	–	(71)	(71)	–	–	(71)
At 31 December 2005	344	2,379	2,039	4,762	–	1	4,763
At 1 January 2006	344	2,379	2,039	4,762	–	1	4,763
Exchange adjustments	35	124	49	208	–	–	208
Charge for the year	–	110	136	246	–	–	246
Reversal of impairment losses, net	(41)	(143)	(16)	(200)	–	–	(200)
Written back on disposals	–	(16)	(26)	(42)	–	–	(42)
At 31 December 2006	338	2,454	2,182	4,974	–	1	4,975
Net book value:							
At 31 December 2006	**588**	**3,185**	**1,450**	**5,223**	**17,728**	**–**	**22,951**
At 31 December 2005	508	2,892	1,006	4,406	16,155	–	20,561

14. Fixed assets *continued*

(a) Movements of fixed assets (HK$m) *continued*

Impairment loss

The Group assessed the recoverable amounts of its fixed assets (other than investment properties) at the balance sheet date in accordance with the policy as disclosed in note 1(m).

As at 31 December 2006, the Directors considered that due to the significant improvement in the Chicago hotel property market, the impairment provision previously made against The Peninsula Chicago should be fully reversed by HK$227 million to its original cost less accumulated depreciation. The reversal of the impairment provision was determined based on the recoverable amount of the property, which is its fair value less costs to sell, determined by an independent professional valuer.

As at 31 December 2006, the Directors considered that Quail Lodge Resort and Golf Course was further impaired as a result of an adverse operating environment and its carrying amount should be written down by **HK$30 million** (2005: HK$86 million) to its recoverable amount, which is its fair value less costs to sell, determined by an independent professional valuer.

As at 31 December 2005, the Directors considered that due to the significant improvement in the operating performance of The Peninsula New York and in the New York hotel property market, the impairment provision previously made against this property should be reversed by HK$62 million to its original cost less accumulated depreciation.

(b) All investment properties of the Group were revalued as at 31 December 2006 on an open market value basis mainly calculated by reference to net rental income allowing for reversionary income potential. The changes in fair value of the investment properties during the year were accounted for in the consolidated income statement. The valuations were carried out by surveyor firms independent of the Group, details of which are as follows:

Description of investment properties	Name of valuer	Qualification of the staff of the valuer conducting the valuation
Hong Kong		
– Retail shops, office and residential apartments	Savills (Hong Kong) Limited	Members of The Hong Kong Institute of Surveyors
Other Asia*		
– Retail shops, office, residential apartments and vacant land	Sallmanns (Far East) Limited Savills (Hong Kong) Limited	Members of The Royal Institution of Chartered Surveyors and The Valuers Association of Thailand
United States of America		
– Retail shops and vacant land	HVS International Jones Lang LaSalle Hotels	Members of the Appraisal Institute, United States of America

* *Other Asia includes the People's Republic of China, Thailand, the Philippines and Vietnam.*

14. Fixed assets *continued*

(c) The analysis of net book value of land held by the Group is as follows (HK$m):

		2006	2005
Hong Kong	– long term leases	**14,034**	12,819
	– medium term leases	**439**	231
		14,473	13,050
Thailand	– freehold	**631**	562
Vietnam	– short term lease	**52**	48
Other Asia		**683**	610
United States of America	– freehold	**374**	333
		15,530	13,993
Representing:			
Land classified as investment properties, at fair value		**14,942**	13,485
Freehold land held for own use		**588**	508
		15,530	13,993

(d) Fixed assets leased out under operating leases

The Group leases out its investment properties under operating leases. The leases typically run for an initial period of one to five years, with or without options to renew the leases after that date at which time all terms are renegotiated. Contingent rentals of these leases were immaterial during 2006 and 2005. All properties held under operating lease that would otherwise meet the definition of investment property are classified as investment property. Future minimum rentals receivable under non-cancellable operating leases of these properties are disclosed in note 32(b).

(e) Major assets under development

Included under plant, machinery and other fixed assets are assets under development in relation to The Peninsula Tokyo project at 31 December 2006 amounting to **HK$528 million** (2005: HK$216 million), which was not subject to depreciation.

14. Fixed assets *continued*

(f) Hotel and investment properties, all held through subsidiary companies, are as follows:

	Usage
Held in Hong Kong:	
Long term leases (over 50 years):	
The Peninsula Hong Kong, Salisbury Road	Hotel and commercial rentals
The Peninsula Office Tower, 18 Middle Road	Office
The Repulse Bay, 109 Repulse Bay Road	Residential and commercial rentals
Repulse Bay Apartments, 101 Repulse Bay Road	Residential
Repulse Bay Garage, 60 Repulse Bay Road	Commercial rentals
St. John's Building, 33 Garden Road	Office
Medium term lease (between 20 and 50 years):	
The Peak Tower, 128 Peak Road	Commercial rentals
Held in the People's Republic of China:	
Medium term lease (between 20 and 50 years):	
The Peninsula Beijing, 8 Goldfish Lane, Wangfujing, Beijing	Hotel and commercial rentals
Held in Thailand:	
Freehold:	
The Peninsula Bangkok, 333 Charoennakorn Road, Klongsan, Bangkok 10600	Hotel and commercial rentals
Thai Country Club, Bangna-Trad, Chachoengsao	Golf club
Land plots, Bangpakong District, Chachoengsao	Undetermined
Held in The Philippines:	
Medium term lease (between 20 and 50 years):	
The Peninsula Manila, Corner of Ayala and Makati Avenues, 1226 Makati City, Metro Manila	Hotel and commercial rentals
Held in Vietnam:	
Short term lease (less than 20 years):	
The Landmark, 5B Ton Duc Thang Street, District 1, Ho Chi Minh City	Residential and commercial rentals
Held in the United States of America:	
Freehold/leasehold:	
Quail Lodge Resort and Golf Club, 8205 Valley Greens Drive, Carmel, California	Hotel and golf club
Vacant land, near Quail Lodge	Undetermined
Freehold/long term leasehold to air rights (over 50 years):	
The Peninsula Chicago, 108 East Superior Street (at North Michigan Avenue), Chicago, Illinois	Hotel
Long term lease (over 50 years):	
The Peninsula New York, 700 Fifth Avenue at 55th Street, New York	Hotel and commercial rentals

14. Fixed assets *continued*

(g) To provide additional information for shareholders, the Directors have commissioned an independent valuation of the Group's hotel properties and golf courses as at 31 December 2006. The total valuation placed on the hotel properties and golf courses, which have a net book value of HK$4,588 million, was HK$7,715 million as at 31 December 2006. It is important to note that the surplus of HK$3,127 million and the related deferred taxation and minority interests has not been incorporated in the consolidated financial statements but is for additional information only. The valuations were carried out by surveyor firms independent of the Group, details of which are as follows:

Description of hotels and golf courses	Name of valuer	Qualification of the staff of the valuer conducting the valuation
Hong Kong and other Asia*		
– Hotels	Jones Lang LaSalle Hotels	Members of Singapore Institute of Surveyors and Valuers
– Golf course	Sallmanns (Far East) Limited	Members of The Royal Institution of Chartered Surveyors and The Valuers Association of Thailand
United States of America		
– Hotels and golf course	HVS International	Members of the Appraisal Institute, United States of America

* *Other Asia includes the People's Republic of China, Thailand and the Philippines.*

15. Investments in subsidiaries (HK$m)

	2006	2005
Unlisted shares, at cost	**94**	94
Provision for impairment	**–**	(23)
	94	71

Particulars of subsidiaries which principally contributed to the results, assets or liabilities of the Group are presented on page 146. The class of shares held is ordinary unless otherwise stated.

16. Interest in jointly controlled entity (HK$m)

	Group 2006	Group 2005
Unlisted shares, at cost (note 16(a))	**–**	–
Share of exchange difference	**16**	4
Share of losses	**(4)**	(3)
Share of net assets	**12**	1
Loan to jointly controlled entity (note 16(b))	**458**	445
	470	446

(a) Details of the jointly controlled entity are as follows:

Company name	Form of business structure	Place of incorporation/ formation	Particulars of issued and paid up capital	Proportion of ownership interest: Group's effective interest	Proportion of ownership interest: Held directly by Company	Proportion of ownership interest: Held indirectly by subsidiary	Principal activity
The Peninsula Shanghai (BVI)Limited ("TPS")*	Incorporated	British Virgin Islands	US$1,000	50%	–	50%	Investment holding

* *TPS holds a 100% direct interest in The Peninsula Shanghai Waitan Hotel Company Limited ("PSW"), a wholly foreign owned enterprise incorporated in the People's Republic of China. PSW is engaged in the project for the development and construction of a hotel to be branded "The Peninsula Shanghai", a Peninsula apartment hotel, a retail arcade and ancillary facilities. At 31 December 2006, the paid up capital of PSW amounted to* ***US$73,500,000*** *(2005: US$70,000,000).*

(b) The loan to the jointly controlled entity is denominated in US dollar, unsecured and interest-free, and has no fixed repayment terms. Part of the loan was contributed as capital of PSW while the remaining portion was on-lent to PSW on an interest-free basis for the purpose of funding the development of the project described in note 16(a) above.

(c) Set out below is a summary of the financial information on the jointly controlled entity, of which the Group has a 50% share.

	2006	2005
Non-current assets	**982**	916
Current assets	**33**	21
Current liabilities	**(39)**	(42)
Non-current liabilities	**(952)**	(892)
Net assets	**24**	3
Income	**–**	–
Expenses	**(3)**	(6)
Loss for the year	**(3)**	(6)

17. Interests in unlisted equity instruments (HK$m)

	Group	
	2006	2005
Unlisted equity securities, at cost	**129**	129
Less: Impairment loss	**(77)**	(77)
	52	52

Unlisted equity securities include:

	Ownership interest held indirectly	Place of incorporation/ establishment
The Belvedere Hotel Partnership	20%	United States of America
PT Ciputra Adigraha	20%	Indonesia

The Belvedere Hotel Partnership ("BHP") holds a 100% interest in The Peninsula Beverly Hills. PT Ciputra Adigraha remained inactive during the year. The Group is not in a position to exercise significant influence over these investments.

BHP has pledged its hotel property and other assets to an independent financial institution as security for BHP's loan facility amounting to **US$75 million** (2005: US$76 million) and the net carrying amount of these pledged assets amounted to **US$65 million** (2005: US$65 million).

18. Derivative financial instruments (HK$m)

(a) Group

	31 December 2006		31 December 2005	
	Assets	**Liabilities**	Assets	Liabilities
Cash flow hedges:				
Interest rate swaps	**10**	**(34)**	6	(32)
Forward foreign exchange contracts	**3**	**–**	3	–
Currency swap	**–**	**(23)**	2	–
	13	**(57)**	11	(32)
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**1**	**(118)**	–	(166)
Currency swaps	**17**	**(39)**	14	(11)
	31	**(214)**	25	(209)
Less: Current portion				
Cash flow hedges:				
Forward foreign exchange contracts	**3**	**–**	2	–
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**–**	**(8)**	–	(5)
	3	**(8)**	2	(5)
Non-current portion	**28**	**(206)**	23	(204)

During 2005, upon the completion of the sale of The Kowloon Hotel and the reduction of bank borrowings in this connection, offsetting interest rate swaps were entered into for the purposes of re-adjusting the loan interest fixing ratio. As a result, some outstanding cash flow hedges became ineffective and were reclassified as interest rate swaps held for trading in 2005.

18. Derivative financial instruments (HK$m) *continued*

(b) Company

	31 December 2006		31 December 2005	
	Assets	**Liabilities**	Assets	Liabilities
Cash flow hedges:				
Interest rate swaps	**1**	**(29)**	–	(56)
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**140**	**(140)**	152	(152)
	141	**(169)**	152	(208)
Less: Current portion				
Cash flow hedges:				
Interest rate swaps	**–**	**(3)**	–	(2)
Held for trading, at fair value through profit or loss:				
Interest rate swaps	**4**	**(4)**	3	(3)
	4	**(7)**	3	(5)
Non-current portion	**137**	**(162)**	149	(203)

19. Income tax in the balance sheet (HK$m)

(a) Current taxation in the balance sheet represents:

	Group		Company	
	2006	2005	**2006**	2005
Provision for Hong Kong Profits Tax for the year	**58**	38	**27**	20
Provisional profits tax paid	**(13)**	(18)	**–**	–
	45	20	**27**	20
Balance of profits tax provision relating to prior years	**9**	3	**11**	2
Provision for overseas taxes	**36**	52	**–**	–
	90	75	**38**	22

Analysed as follows:

	Group		Company	
	2006	2005	**2006**	2005
Taxation recoverable	**(3)**	(3)	**–**	–
Current taxation	**93**	78	**38**	22
	90	75	**38**	22

19. Income tax in the balance sheet (HK$m) *continued*

(b) Deferred tax assets and liabilities recognised

The components of deferred tax (assets)/liabilities of the Group recognised in the consolidated balance sheet and the movements during the year are as follows:

	Group					
	Revaluation of investment properties	Tax allowances in excess of the related depreciation	Provisions and others	Tax losses	Cash flow hedges	Total
Deferred tax arising from:						
At 1 January 2005	2,134	415	(22)	(141)	(53)	2,333
Acquisition of a subsidiary	–	–	–	(6)	–	(6)
Disposal of a subsidiary	–	(7)	–	–	–	(7)
Charged/(credited) to profit or loss	164	85	(1)	(129)	–	119
Charged/(credited) to reserves	(3)	(1)	(1)	–	20	15
At 31 December 2005	2,295	492	(24)	(276)	(33)	2,454
At 1 January 2006	2,295	492	(24)	(276)	(33)	2,454
Charged/(credited) to profit or loss	249	67	(4)	(19)	–	293
Charged/(credited) to reserves	12	15	–	(1)	9	35
At 31 December 2006	2,556	574	(28)	(296)	(24)	2,782

The balance as at 31 December 2006 includes a provision for deferred tax liabilities with regard to revaluation of the Group's investment properties in Hong Kong amounting to **HK$2,407 million** (2005: HK$2,177 million). The Directors have no intention of selling the Group's investment properties in Hong Kong and consider that should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in Hong Kong.

	Group	
	2006	2005
Net deferred tax asset recognised on the balance sheet	**(98)**	(123)
Net deferred tax liability recognised on the balance sheet	**2,880**	2,577
	2,782	2,454

	Company	
	2006	2005
Deferred tax asset arising from cash flow hedges	**5**	10

19. Income tax in the balance sheet (HK$m) *continued*

(c) Deferred tax assets not recognised

The Group has not recognised the following potential deferred tax assets:

	Group	
	2006	2005
Depreciation allowances in excess of book depreciation	**39**	44
Future benefit of tax losses	**66**	144
Revaluation deficits	**–**	11
Provision and others	**16**	8
	121	207

In accordance with the accounting policy set out in note 1(t), the Group has not recognised deferred tax assets in respect of certain cumulative tax losses of **HK$329 million** (2005: HK$556 million) as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdiction and entity. Details of the expiry date of unused tax losses are as follows:

	Group	
	2006	2005
Within 1 year	**40**	238
After 1 year but within 5 years	**51**	69
After 5 years but within 10 years	**2**	8
Without expiry date	**236**	241
	329	556

20. Inventories (HK$m)

	Group	
	2006	2005
Land lots for sale	**4**	4
Food and beverage and others	**82**	73
	86	77

The cost of inventories recognised as expenses in the consolidated income statement amounted to **HK$283 million** (2005: HK$232 million).

21. Debtors and payments in advance (HK$m)

	Group		Company	
	2006	2005	**2006**	2005
Loans and other receivables due from subsidiaries	**–**	–	**13,789**	13,619
Provision for impairment	**–**	–	**(2,655)**	(3,458)
	–	–	**11,134**	10,161
Trade debtors (ageing analysis is shown below)	**114**	94	**–**	–
Rental deposits and payments in advance	**194**	122	**19**	12
	308	216	**11,153**	10,173

Loans and other receivables due from subsidiaries are unsecured, interest free and have no fixed terms of repayment except for an amount of **HK$3,361 million** (2005: HK$3,257 million) which bear interest at market rate. The Directors consider that the carrying amount of all debtors and payments in advance approximates their fair value.

The ageing analysis of trade debtors is as follows:

	Group	
	2006	2005
Less than 3 months	**101**	90
3 months to 6 months	**9**	3
More than 6 months	**4**	1
	114	94

The Group's credit policy is set out in note 31(d).

22. Cash and cash equivalents (HK$m)

	Group		Company	
	2006	2005	**2006**	2005
Cash and cash equivalents in the balance sheet	**447**	301	**5**	7
Bank overdrafts (note 24)	**(14)**	(16)		
Cash and cash equivalents in the consolidated cash flow statement	**433**	285		

Cash and cash equivalents at the end of the year include deposits with banks of **HK$222 million** (2005: HK$115 million) held by subsidiaries that are not freely remittable to the holding company because of currency exchange restrictions.

Included in cash and cash equivalents in the balance sheet are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	Group		Company	
	2006 million	2005 million	**2006 million**	2005 million
US dollars	**USD 4**	USD 5	**–**	–
Philippines pesos	**PHP 23**	PHP 42	**PHP 23**	PHP 42

23. Creditors and accruals (HK$m)

	Group		Company	
	2006	2005	**2006**	2005
Trade creditors (ageing analysis is shown below)	**84**	66	**–**	–
Interest payable	**9**	8	**–**	2
Accruals of fixed assets	**172**	43	**–**	–
Tenants' deposits	**306**	258	**–**	–
Golf membership deposits	**49**	43	**–**	–
Other payables	**491**	447	**10**	16
Other payables to subsidiaries	**–**	–	**5**	2
	1,111	865	**15**	20

The ageing analysis of trade creditors is as follows:

	Group		Company	
	2006	2005	**2006**	2005
Less than 3 months	**83**	65	**–**	–
3 months to 6 months	**–**	1	**–**	–
More than 6 months	**1**	–	**–**	–
	84	66	**–**	–

24. Interest-bearing borrowings (HK$m)

	Group	
	2006	2005
Total facilities available:		
Term loans and revolving credits	**3,942**	4,387
Uncommitted facilities, including bank overdrafts	**1,116**	1,086
	5,058	5,473
Utilised at 31 December:		
Term loans and revolving credits	**2,463**	2,594
Uncommitted facilities, including bank overdrafts	**60**	20
	2,523	2,614
Represented by:		
Short-term bank loans, repayable within one year or on demand	**257**	88
Current portion of long-term bank loans, repayable within one year	**35**	35
Bank overdrafts, repayable on demand (note 22)	**14**	16
	306	139
Long-term bank loans, repayable:		
Within 1 year	**35**	35
Between one and two years	**537**	1,244
Between two and five years	**1,680**	1,164
After five years	**–**	67
	2,252	2,510
Less: Current portion of long-term bank loans	**(35)**	(35)
Non-current portion of long-term bank loans	**2,217**	2,475
Total interest-bearing borrowings	**2,523**	2,614

24. Interest-bearing borrowings (HK$m) *continued*

The non-current portion of long-term bank loans are not expected to be settled within one year. The total borrowings comprised the following variable rate bank loans and overdrafts that were:

	Group	
	2006	2005
Unsecured	**2,523**	2,547
Secured mortgages over investment and hotel properties of a PRC subsidiary	**–**	67
Total interest-bearing borrowings	**2,523**	2,614

As at 31 December 2005, the secured banking facility and the book value of the mortgaged properties amounted to HK$384 million and HK$1,315 million respectively. The secured borrowings were fully repaid in 2006.

Included in interest-bearing borrowings are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	Group	
	2006 million	2005 million
US dollars	**USD 81**	USD 104
Japanese yen	**JPY 2,132**	JPY 2,666

All the above US dollar borrowings were obtained by a Hong Kong subsidiary. In light of the Hong Kong dollar peg, the Directors consider that the foreign exchange risk associated with these US dollar borrowings are not expected to be material to the Group. As at 31 December 2006 and 2005, a Thai subsidiary had an amortising bank loan in Japanese yen, which was hedged and swapped to its functional currency by means of a cross currency swap. The Group classifies this currency swap as a cash flow hedge as disclosed in note 18(a).

All of the Group's banking facilities are subject to the fulfillment of covenants relating to some of the Group's balance sheet ratios, as are commonly found in lending arrangements with financial institutions. If the Group were to breach the covenants the drawn down facilities would become payable on demand. The Group regularly monitors its compliance with these covenants. Further details of the Group's management of liquidity risk are set out in note 31. As at 31 December 2006 and 2005, none of the covenants relating to drawn down facilities had been breached.

25. Share capital

	2006	2005
Number of shares of HK$0.50 each (million)		
Authorised	**1,800**	1,800
Issued		
At 1 January	**1,417**	1,402
New shares issued	**11**	15
At 31 December	**1,428**	1,417
Nominal value of shares (HK$m)		
Authorised	**900**	900
Issued		
At 1 January	**709**	701
New shares issued	**5**	8
At 31 December	**714**	709

During the year, the Company issued and allotted **5.9 million (at HK$9.33 per share)** (2005: $7.5 million at HK$7.62 per share) and **5 million (at HK$10.128 per share)** (2005: 2.3 million at HK$9.21 per share) new shares in respect of the **2005 final scrip dividend** (2005: 2004 final scrip dividend) and **2006 interim scrip dividend** (2005: 2005 interim scrip dividend) respectively. In 2005, the Company issued and allotted approximately 5.5 million new shares (at HK$5.855 per share) as part consideration to acquire 31.68% additional interest in Manila Peninsula Hotel, Inc. The new shares issued have resulted in an increase in fully paid share capital of **HK$5 million** (2005: HK$8 million) and share premium of **HK$100 million** (2005: HK$103 million) as disclosed in note 26. All ordinary shares issued during the year rank pari passu in all respects with the existing shares in issue. All shareholders are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets.

26. RESERVES (HK$m)

(a) Group

	Attributable to equity shareholders of the Company								
	Share premium	Capital redemption reserve	Hedging reserve	Exchange reserve	General reserve	Retained profits	Sub-total	Minority interests	Total
At 1 January 2005	2,582	9	(277)	(631)	1,098	8,556	11,337	614	11,951
Dividends approved in respect of the previous year	54	–	–	–	–	(126)	(72)	–	(72)
Exchange differences on translation of financial statements of overseas subsidiaries	–	–	–	4	–	–	4	2	6
Cash flow hedges: effective portion of changes in fair value, net of tax	–	–	48	–	–	–	48	2	50
Cash flow hedges: transfer from equity to profit or loss, net of tax	–	–	214	–	–	–	214	–	214
Profit for the year	–	–	–	–	–	2,664	2,664	57	2,721
New shares issued	29	–	–	–	–	–	29	–	29
Dividends declared in respect of the current year	20	–	–	–	–	(57)	(37)	(5)	(42)
Acquisition of subsidiary	–	–	–	–	–	–	–	40	40
At 31 December 2005	2,685	9	(15)	(627)	1,098	11,037	14,187	710	14,897
At 1 January 2006	2,685	9	(15)	(627)	1,098	11,037	14,187	710	14,897
Dividends approved in respect of the previous year	52	–	–	–	–	(142)	(90)	–	(90)
Exchange differences on translation of financial statements of overseas subsidiaries	–	–	–	103	–	–	103	49	152
Cash flow hedges: effective portion of changes in fair value, net of tax	–	–	(27)	–	–	–	(27)	(2)	(29)
Cash flow hedges: transfer from									
– equity to profit or loss, net of tax	–	–	20	–	–	–	20	–	20
– fixed assets, net of tax	–	–	4	–	–	–	4	–	4
Profit for the year	–	–	–	–	–	2,094	2,094	29	2,123
Dividends declared in respect of the current year	48	–	–	–	–	(71)	(23)	(3)	(26)
At 31 December 2006	**2,785**	**9**	**(18)**	**(524)**	**1,098**	**12,918**	**16,268**	**783**	**17,051**

26. Reserves (HK$m) *continued*

(b) Company

	Share premium	Capital redemption reserve	Capital reserve	Hedging reserve	General reserve	Retained profits	Total
At 1 January 2005	2,582	9	4,975	–	980	364	8,910
Dividends approved in respect of the previous year	54	–	–	–	–	(126)	(72)
Cash flow hedge: effective portion of changes in fair value, net of tax	–	–	–	(51)	–	–	(51)
Cash flow hedge: transfer from equity to profit or loss, net of tax	–	–	–	5	–	–	5
New shares issued	29	–	–	–	–	–	29
Profit for the year	–	–	–	–	–	670	670
Dividends declared in respect of the current year	20	–	–	–	–	(57)	(37)
At 31 December 2005	2,685	9	4,975	(46)	980	851	9,454
At 1 January 2006	2,685	9	4,975	(46)	980	851	9,454
Dividends approved in respect of the previous year	52	–	–	–	–	(142)	(90)
Cash flow hedge: effective portion of changes in fair value, net of tax	–	–	–	6	–	–	6
Cash flow hedge: transfer from equity to profit or loss, net of tax	–	–	–	17	–	–	17
Profit for the year	–	–	–	–	–	1,098	1,098
Dividends declared in respect of the current year	48	–	–	–	–	(71)	(23)
At 31 December 2006	**2,785**	**9**	**4,975**	**(23)**	**980**	**1,736**	**10,462**

(c) Nature and purpose of reserves

Share premium and capital redemption reserve

The application of the share premium account and the capital redemption reserve is governed by Sections 48B and 49H respectively of the Hong Kong Companies Ordinance.

Capital reserve

The Company's capital reserve represents the profit recognised on the intra-group transfer of properties as a result of the corporate restructuring in 1991.

26. Reserves (HK$m) *continued*

(c) Nature and purpose of reserves *continued*

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flows in accordance with the accounting policy adopted for cash flow hedges in note 1(h).

Exchange reserve

The exchange reserve comprised all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as the effective portion of any foreign exchange differences arising from hedges of the net investment in these foreign operations. The reserve is dealt with in accordance with the accounting policies set out in notes 1(h) and 1(w).

General reserve

General reserve represents retained profits set aside for general purposes.

(d) Distributability of reserves

At 31 December 2006, the aggregate amount of reserves available for distribution to shareholders of the Company was **HK$2,716 million** (2005: HK$1,831 million). After the balance sheet date the Directors proposed a final dividend of **11 cents per share** (2005: 10 cents per share), amounting to **HK$157 million** (2005: HK$142 million). This dividend has not been recognised as a liability at the balance sheet date.

27. Business combination

On 3 March 2005, the Group increased its shareholding in Manila Peninsula Hotel, Inc. ("MPHI") from 40% to 71.68%. The consideration of approximately HK$44 million was satisfied by a cash payment of HK$12 million and the issue and allotment of approximately 5.5 million new shares of the Company at a value of HK$5.855 per share.

On 3 November 2005, the Group further increased its interest in MPHI to 76.09% through the conversion of a shareholder loan amounting to HK$25.9 million for additional shares of MPHI.

The consolidation of MPHI resulted in an increase of approximately HK$147 million in turnover during 2005. Details of the assets and liabilities arising from the acquisition of MPHI are disclosed in note 28.

There was no acquisition during the year ended 31 December 2006.

28. Net cash (outflow)/inflow of cash and cash equivalents arising from the acquisition/disposal of subsidiaries during 2005 (HK$m)

	Acquisition	Disposal
Cash consideration paid	(12)	–
Balance of sales consideration received, net of expenses	–	1,687
Cash and cash equivalents acquired/(disposed of)	10	(3)
	(2)	1,684
Details of net assets acquired/(disposed of) and the consideration (paid)/received are analysed below:		
Properties, plant and equipment	176	(264)
Investment properties	8	(452)
Current assets	20	(18)
Cash and cash equivalents	10	(3)
Current taxation	(1)	7
Deferred taxation	6	7
Current liabilities	(42)	18
Interest-bearing borrowings	(10)	–
Minority interests	(40)	–
Net assets acquired/(disposed of)	127	(705)
Interest in an associate	(83)	–
Gain on disposal of a subsidiary (note 5)	–	(1,171)
	44	(1,876)
Consideration:		
Cash consideration paid	(12)	–
New shares issued	(32)	–
Sales consideration received, net of expenses	–	1,876
	(44)	1,876

29. Loans to officers

Loans to officers of the Company and its subsidiaries disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

(a) Loans made by a third party under guarantees given by the Company

Name of borrower:	Mr. Martyn P. A. Sawyer
Position:	Group General Manager, Properties and Clubs
Extent of guarantee given to a bank	GBP120,000
Maximum liability under the guarantee:	
at 1 January 2005	HK$1,245,000
at 31 December 2005 and 1 January 2006	HK$1,205,000
at 31 December 2006	HK$1,165,000
Amount paid or liability incurred under the guarantee	**HK$nil** (2005: HK$nil)

The guarantee is given without recourse to the officer. The Directors do not consider it probable that the Company will be called upon under the guarantee. The guarantee will be outstanding until a loan granted to the officer by the bank is repaid, and the loan has a remaining term until 2014.

(b) Loans made by the Company and its subsidiaries

Name of borrower:	Mr. Peter C. Borer	Mr. J. Niklaus Leuenberger
Position:	Director	Senior Vice President, The Americas, The Peninsula Hotels
Terms of the loan:		
duration and repayment terms	5 years to May 2007	Approximately 2 years to December 2006
interest rate	The Company's borrowing rate	Interest-free
security	Borrower's retirement fund	None
Balance of the loan:		
at 1 January 2005	HK$954,830	US$20,000
at 31 December 2005 and 1 January 2006	HK$559,727	US$ nil
at 31 December 2006	HK$ nil	US$ nil
Maximum balance outstanding:		
during 2005	HK$954,830	US$20,000
during 2006	HK$559,727	US$ nil

There was no amount due but unpaid, nor any provision made against the principal amount of or interest on these loans at 31 December 2005 and 2006.

The Company does not have the right to call upon the security held as collateral in the absence of default by the officer.

30. Employee retirement benefits

(a) Defined benefit retirement obligations

Manila Peninsula Hotel, Inc. ("MPHI"), a Philippine subsidiary of the Company, operates a non-contributory defined benefit retirement plan which covers all its employees. The plan is administered by an independent trustee with the assets held separately from those of MPHI.

The above plan is funded by contributions from MPHI in accordance with an independent actuary's recommendation based on annual actuarial valuation. The latest independent actuarial valuation of the plan was prepared by qualified staff of Actuarial Advisers, Inc., who are members of the Actuarial Society of the Philippines, using the projected unit credit method at 31 December 2006. The actuarial valuation indicated that MPHI's obligations under the defined benefit retirement plan were **50%** (2005: 46%) covered by the plan assets held by the trustee. The uncovered obligations were fully provided for as at 31 December 2006.

Quail Lodge, Inc. ("QLI"), a U.S. subsidiary of the Company, has retirement compensation agreements with certain employees which provide, among other things, that during the employees' lifetime after retirement, QLI will pay such employees retirement compensation equal to 30% of their average salaries in their final three years of employment. The pension liabilities were valued at **HK$5 million** (2005: HK$5 million) using a discount rate of **6.5%** (2005: 6.5%).

QLI also has a deferred compensation agreement with a now deceased key employee who died in 2005. The agreement provides, among other things, that during each of the 10 years after termination of his employment because of retirement, death or disability, such employee or his estate would be paid deferred compensation, adjusted for cost-of-living increases. The net present value of this commitment, computed by using a discount rate of **6.5%** (2005: 6.5%), was approximately **HK$3 million** (2005: HK$4 million) as of 31 December 2006, and was included in the net defined benefit retirement obligation in the consolidated balance sheet.

QLI has not funded the above retirement and deferred compensation arrangements, and the liability in respect of its obligations was fully recognised in its financial statements at each year end date based on independent actuarial valuation.

The amounts recognised in the Group's balance sheet are as follows (HK$m):

	Group	
	2006	2005
Present value of wholly or partly funded obligations	**32**	28
Fair value of plan assets	**(11)**	(8)
	21	20
Unrecognised actuarial gains	**2**	3
	23	23

A portion of the above liability is expected to be settled after more than one year. However, it is not practicable to segregate this amount from the amounts payable in the next twelve months, as future contributions will also relate to future services rendered and future changes in actuarial assumptions and market conditions. The Group expects to pay HK$3 million in contributions to defined benefit retirement plans in 2007.

30. Employee retirement benefits *continued*

(a) Defined benefit retirement obligations *continued*

Plan assets consist of the following (HK$m):

	Group 2006	Group 2005
Stocks	**6**	6
Mutual funds	**5**	2
	11	8

Movements in the present value of the defined benefit obligations (HK$m):

	Group 2006	Group 2005
At 1 January	**28**	10
Exchange adjustments	**1**	1
Acquisition of MPHI	**–**	32
Benefits paid by the plans	**(3)**	(18)
Current service cost	**3**	1
Interest cost	**2**	5
Actuarial loss/(gain)	**1**	(3)
At 31 December	**32**	28

Movements in plan assets (HK$m):

	Group 2006	Group 2005
At 1 January	**8**	–
Exchange adjustments	**1**	1
Acquisition of MPHI	**–**	18
Group's contributions paid by the plans	**2**	4
Benefits paid by the plans	**(1)**	(18)
Actuarial expected return on plan assets	**1**	2
Actuarial gain	**–**	1
At 31 December	**11**	8

The expense recognised as staff costs in the consolidated income statement is as follows (HK$m):

	Group 2006	Group 2005
Current service cost	**3**	1
Interest cost	**2**	5
Actuarial expected return on plan assets	**(1)**	(2)
Actuarial gain	**(2)**	–
	2	4

The actual return on plan assets (taking into account all changes in the fair value of the plan assets excluding contributions paid and received) was net income of **HK$1 million** (2005: HK$3 million).

30. Employee retirement benefits *continued*

(a) Defined benefit retirement obligations *continued*

The principal actuarial assumptions used as at 31 December 2006 are as follows:

	Group	
	2006	2005
Discount rate	**from 4.7% to 11.6%**	from 6.5% to 14.0%
Expected rate of return on plan assets	**9.6%**	10%
Future salary increases	**from 3% to 5.7%**	6.2%

The expected long-term rate of return on plan assets is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns without adjustments.

Historical information (HK$m):

	Group
	2006
Present value of defined benefit obligations	**32**
Fair value of plan assets	**(11)**
Deficit in the plan	**21**
Experience adjustments arising on plan liabilities	**15**
Experience adjustments arising on plan assets	**1**

In accordance with the transition provision for the amendments to HKAS 19, the disclosures above are determined prospectively from 1 January 2006.

(b) Defined contribution retirement plan

The Group has a defined contribution retirement plan covering **1,259 employees** (2005: 1,177 employees) mostly in Hong Kong. The defined contribution retirement plan is formally established under an independent trust with the assets of the funds held separately from those of the Group by an independent trustee. The plan is registered under the Occupational Retirement Schemes Ordinance and is exempted under the Mandatory Provident Fund Schemes (Exemption) Regulation. Employees covered by this plan are not required to make contributions and funds contributed by employers are fully vested immediately. The average contribution rate against employees' relevant income for the year was **12%** (2005: 13%).

In addition, the Group also participates in the Mandatory Provident Fund Scheme operated by an independent service provider to cover **398 employees** (2005: 182 employees) in Hong Kong not covered by the above defined contribution retirement plan. Contributions at a fixed rate of 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK$20,000 per employee, are made to the scheme and are vested immediately.

The Group also operates several defined contribution retirement plans including union pension schemes for its overseas subsidiaries covering **2,384 employees** (2005: 2,366 employees) in other Asian countries and the United States of America in accordance with respective applicable labour regulations.

Total contributions to all of the above defined contribution retirement plans made by the Group amounting to **HK$58 million** (2005: HK$53 million) were charged to the income statement during the year.

31. Financial instruments (HK$m)

The Group is exposed to foreign exchange, interest rate, liquidity and credit risks in its normal course of business. Various techniques and derivative financial instruments are used to control or reduce these risks, as described below.

(a) Foreign exchange risk

The Group manages its foreign exchange exposure with a view to protecting its net assets and profitability against adverse fluctuations in exchange rates. The Company reports its results in Hong Kong dollars. In light of the Hong Kong dollar peg, the Group does not hedge US dollar exposures, and it aims to preserve its value in Hong Kong dollar and/or United States dollar terms.

Forecast transactions

Foreign exchange risk may arise in sale and purchase transactions that are denominated in a currency other than the functional currency of the operations to which they relate.

In respect of committed future transactions and highly probable forecast transactions, the Group hedges most of the estimated foreign currency transaction exposures if the foreign exchange risk of these exposures is considered to be significant. The Group mainly uses forward exchange contracts to hedge this type of foreign exchange risk and classifies these contracts as cash flow hedges.

At 31 December 2006, the Group had forward foreign exchange contracts hedging forecast transactions in respect of a project in Tokyo with a net fair value of **HK$3 million** (2005: HK$3 million), recognised as derivative financial instruments. These forward exchange contracts have maturities of less than **one year** (2005: less than two years) after the balance sheet date.

Recognised assets and liabilities

The Group has foreign currency monetary assets and liabilities that are denominated in a currency other than the functional currency of the operations to which they relate. Exchange differences arising on settling or translating these foreign currency monetary items at rates different from those at dates of transactions giving rise to these monetary items are recognised in the income statement.

The Group hedges most of the foreign exchange exposures arising from significant foreign currency monetary assets and liabilities, including foreign currency borrowings. The Group mainly uses currency swaps or forward exchange contracts to hedge this type of foreign exchange risk and classifies these derivative financial instruments as cash flow hedges or held for trading depending on whether the future foreign currency cash flows are fixed or not. Changes in the fair value of these cash flow hedges or derivative financial instruments held for trading are recognised in the hedging reserve or the income statement respectively.

31. Financial instruments (HK$m) *continued*

At 31 December 2006, the net fair value of currency swaps used by the Group to hedge foreign currency borrowings was as follows:

	Group	
	2006	2005
Cash flow hedges	**(23)**	2
Held for trading	**(22)**	3
	(45)	5

In respect of other debtors and creditors that are denominated in a currency other than the functional currency of the operations to which they relate, the Group monitors the net exposure, which is not material. The Group usually sells and buys foreign currencies at spot rates to settle these debtors and creditors.

Except for foreign currency borrowings hedged by currency swaps or forward foreign exchange contracts, all the Group's borrowings are denominated in the functional currency of the operations to which they relate or, in case of group entities whose functional currency is Hong Kong dollars, in either Hong Kong dollars or United States dollars. Given this, it is not expected that there will be any significant currency risk associated with the Group's borrowings.

Net investment in foreign subsidiary

At 31 December 2006 and 2005, the Group did not hedge any net investment in foreign subsidiaries.

(b) Interest rate risk

All the Group's borrowings bear floating interest rates that are reset on a regular basis as market interest rates change. As the borrowing costs are subject to market fluctuations in interest rates, the Group adopts a policy to fix interest rates of 40% to 70% of the exposure, with a long-term target of 50%, mainly by way of interest rate swaps or other derivative financial instruments.

Following the disposal of The Kowloon Hotel in 2005, the Group applied the sale proceeds towards reducing bank borrowings and re-adjusting the loan interest hedging ratio, rendering some outstanding interest rate swaps ineffective at the Group level (see note 5). The Company entered into new interest rate swaps to offset the financial effect of the ineffective interest rate swaps, and classified these new swaps as cash flow hedges against intra-group borrowings. However, the Group classified these pairs of offsetting interest rate swaps as held for trading, and changes in their fair value are recognised in the consolidated income statement because the intra-group borrowings are eliminated upon consolidation. At 31 December 2006, these pairs of swaps had a total notional principal of **HK$3,458 million** (2005: HK$3,658 million) maturing over the next **seven years** (2005: eight years).

31. Financial instruments (HK$m) *continued*

(b) Interest rate risk *continued*

At 31 December 2006, the Group and the Company had interest rate swaps that are classified as cash flow hedges with a total notional contract amount of **HK$1,446 million** (2005: HK$1,448 million) and **HK$1,729 million** (2005: HK$1,829 million) maturing over the next **11 years** (2005: 12 years) and **seven years** (2005: eight years) respectively. Changes in fair value of these interest rate swaps for cash flow hedges are recognised in the hedging reserve. The Group locked in the following ranges of fixed rates by the interest rate swaps at 31 December 2006:

	31 December 2006	31 December 2005
HK dollars	**4.8% to 4.9%**	4.8% to 4.9%
US dollars	**4.6% to 5.8%**	4.6% to 5.8%
Japanese yen	**1.5% to 2.1%**	1.5% to 2.1%

The net fair value of all the interest rate swaps, recognising as derivative financial instruments, entered into by the Group and the Company at 31 December 2006 was as follows:

	Group		Company	
	2006	2005	**2006**	2005
Cash flow hedges	**(24)**	(26)	**(28)**	(56)
Held for trading	**(117)**	(166)	**–**	–
	(141)	(192)	**(28)**	(56)

In respect of interest-earning financial assets and interest-bearing financial liabilities (including borrowings), the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice or the maturity dates, if earlier.

31. Financial instruments (HK$m) *continued*

(b) Interest rate risk *continued*

Group	2006						2005					
	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years
Repricing dates for assets/(liabilities) which reprice before maturity												
Cash and cash equivalents	**1.8%**	**323**	**323**	**–**	**–**	**–**	2.0%	258	258	–	–	–
Debtors	**–**	**–**	**–**	**–**	**–**	**–**	5.2%	1	1	–	–	–
Bank loans	**4.5%**	**(2,509)**	**(2,509)**	**–**	**–**	**–**	4.3%	(2,598)	(2,598)	–	–	–
Effect of derivative financial instruments on bank loans	**0.2%**	**–**	**1,359**	**(105)**	**(273)**	**(981)**	0.4%	–	1,330	(35)	(105)	(1,190)
		(2,186)	**(827)**	**(105)**	**(273)**	**(981)**		(2,339)	(1,009)	(35)	(105)	(1,190)

Company	2006						2005					
	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years	Effective interest rate %	Total	One year or less	1-2 years	2-5 years	More than 5 years
Repricing dates for assets/(liabilities) which reprice before maturity												
Cash and cash equivalents	**4.3%**	**4**	**4**	**–**	**–**	**–**	5.5%	6	6	–	–	–
Loans to subsidiaries	**4.8%**	**3,361**	**3,361**	**–**	**–**	**–**	4.9%	3,257	3,257	–	–	–
Effect of derivative financial instruments on loans to subsidiaries	**(0.7%)**	**–**	**(1,134)**	**100**	**834**	**200**	(0.8%)	–	(1,532)	498	500	534
		3,365	**2,231**	**100**	**834**	**200**		3,263	1,731	498	500	534

(c) Liquidity risk

Borrowings and cash management, including short term investment of surplus cash, are arranged centrally to cover expected cash demands. The Group's policy is to regularly monitor current and expected liquidity requirements and its compliance with loan covenants, and to ensure that it maintains sufficient cash reserves and adequate committed borrowing facilities from major financial institutions to meet its obligations and commitments in the short and longer term.

At 31 December 2006, total available borrowing facilities amounted to **HK$5,058 million** (2005: HK$5,473 million) of which **HK$2,523 million** (2005: HK$2,614 million) was drawn down. Undrawn committed facilities, in the form of revolving credit and term loan facilities, totalled **HK$1,479 million** (2005: HK$1,793 million).

(d) Credit risk

The Group's credit risk is primarily attributable to bank deposits, trade debtors and derivative financial instruments, and is monitored on an ongoing basis.

Cash is deposited in financial institutions with good credit ratings that are located where the Group entities are operated. At 31 December 2006, bank deposits amounted to **HK$400 million** (2005: HK$318 million), of which over **90%** (2005: 90%) were made to financial institutions with credit ratings of no less than BBB- (Standard & Poor's) or Baa2 (Moody's). The Directors consider that it is highly unlikely that any of these financial institutions will fail to meet their obligations.

The Group has no concentrations of credit risk in view of its large number of customers. The Group maintains a defined credit policy to ensure that credit is given only to customers with an appropriate credit history. In respect of the Group's rental income from operating leases, rentals are normally received in advance and sufficient rental deposits are held to cover potential exposure to credit risk. As such, the Group normally does not obtain collateral from its customers. The ageing of trade debtors at 31 December 2006 is summarised in note 21.

Transactions involving derivative financial instruments are with financial institutions with sound credit ratings. Given their high credit ratings, the Directors consider that it is highly unlikely that any of these financial institutions will fail to meet their obligations. At 31 December 2006, the credit ratings of these financial institutions were no less than A (Standard & Poor's) or A2 (Moody's).

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including the derivative financial instrument, in the balance sheet. Except for the financial guarantee given by the Group as set out in note 33, the Group does not provide any other guarantee which would expose the Group or the Company to credit risk.

(e) Sensitivity analysis

In managing foreign exchange and interest rate risks, the Group aims to reduce the impact of short term fluctuations on the Group's earnings. Over the longer term, however, permanent changes in foreign exchange and interest rates would have an impact on consolidated earnings.

At 31 December 2006, it is estimated that a general increase of one percentage point in interest rates would decrease the Group's profit before tax by approximately **HK$7 million** (2005: HK$11 million), so far as the effect on interest bearing financial instruments is concerned. Interest rate swaps have been included in this calculation.

31. Financial instruments (HK$m) *continued*

(f) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2006 except that interests in unlisted equity instruments are stated at cost less impairment losses (see note 1(f)). The fair values of the equity instruments cannot be reasonably measured because they can only be sold either with the consent of third parties or in an illiquid market. The loans to subsidiaries are unsecured, interest free and have no fixed repayment term. Given these terms it is not meaningful to disclose the fair values of loans to subsidiaries.

(g) Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

Derivative financial instruments

Forward foreign exchange contracts are either marked to market using listed market prices or by discounting the contractual forward price and deducting the current spot rate. The fair value of interest rate swaps is the estimated amount that the Group or Company would receive or pay to terminate the swaps at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

When discounted cash flow techniques are used, estimated future cash flows are based on the management's best estimates and the discount rate is a market related rate for a similar instrument at the balance sheet date. Where other pricing models are used, inputs are based on market related data at the balance sheet date.

The Group uses the following discount rates for determining fair value of derivative financial instruments.

	31 December 2006	31 December 2005
Hong Kong dollar	**3.9%-4.8%**	4.0%-6.8%
United States dollar	**4.7%-5.5%**	4.2%-5.3%
Thai baht	**5.1%-5.3%**	4.3%-5.8%
Japanese yen	**0.5%-2.7%**	0.1%-2.8%
Philippines peso	**6.4%**	7.4%

Interest-bearing borrowings

The fair value is estimated as the present value of future cash flows, discounted at current market interest rates for similar borrowings.

32. Commitments (HK$m)

(a) Capital commitments outstanding at 31 December 2006 not provided for in the financial statements were as follows:

	Group	
	2006	2005
Contracted for	**376**	525
Authorised but not contracted for	**1,871**	2,054
	2,247	2,579

Capital commitments include amounts in respect of the Group's capital expenditure at existing properties and its commitment to the projects in Tokyo and Shanghai.

(b) At 31 December 2006, the total future minimum lease payments under non-cancellable operating leases of the Group in respect of land and buildings are (receivable)/payable as follows:

	Receivable		Payable	
	2006	2005	**2006**	2005
Within 1 year	**(633)**	(542)	**83**	60
After 1 year but within 5 years	**(808)**	(710)	**520**	470
After 5 years	**(149)**	(203)	**7,502**	7,647
	(1,590)	(1,455)	**8,105**	8,177

Following the completion of the restructuring of The Palace Hotel Co., Ltd. ("TPH") on 13 December 2002, the Group is committed to making an annual payment of a minimum of RMB 8 million to China Everbright Group Limited ("CEG") up to and including 11 November 2033 (the "Annual Payment"). The Annual Payment is a deemed lease payment and is included as a payment under non-cancellable operating leases of the Group (note 34(f)).

Manila Peninsula Hotel, Inc. ("MPHI") became a non-wholly owned subsidiary of the Group on 3 March 2005 (see note 27). The Peninsula Manila, the hotel owned by MPHI, is situated on a piece of land which belongs to Ayala Hotel, Inc. ("Ayala"). The hotel land lease was negotiated in 1975 by the management of MPHI at the time with Ayala in the ordinary and usual course of business based on normal commercial terms and on an arm's length basis (the "Land Lease"). The initial term of the Land Lease was from 31 December 1975 to 31 December 2001, with an option to renew until 31 December 2027 on the same terms and conditions, which was exercised by MPHI. Pursuant to the terms and conditions, MPHI is committed to paying Ayala annual rental at 5% of its gross income on a quarterly basis. As Ayala is an associate of an MPHI director (hence a connected person of the parent company), and MPHI is a non wholly-owned subsidiary, the Land Lease therefore became a continuing connected transaction as defined under the Listing Rules.

The Group also leases certain pieces of land in respect of its hotels located in the United States of America from third parties under long term leases. In addition, the Group leases a number of office premises under operating leases that typically run for an initial period of two to four years with an option to renew the leases when all the terms are renegotiated. None of the leases includes contingent rentals.

The Group entered into a long term lease with respect to The Peninsula Tokyo commencing on the date of completion which is expected to be in 2007.

33. Contingent liabilities (HK$m)

Contingent liabilities at 31 December are analysed as follows:

	Group		Company	
	2006	2005	**2006**	2005
Guarantees given in respect of borrowings and other banking facilities for subsidiaries	**–**	–	**2,508**	2,547
Other guarantees	**3**	5	**3**	5
Legal and other disputes	**–**	13	**–**	–
	3	18	**2,511**	2,552

The Company has not recognised any deferred income for the guarantees given in respect of borrowing and other banking facilities for subsidiaries as their fair value cannot be reliably measured and their transaction price was HK$nil.

The Directors consider that the above contingent liabilities are unlikely to materialise. No provision was therefore made in this respect at 31 December 2006 and 2005.

34. Material related party transactions

(a) Under a tenancy agreement which 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 charges of HK$146,531 (up to September 2006) and HK$161,560 (from October 2006 onwards) per month from Kadoorie Estates Limited which is an agent for the owner which is indirectly owned by our controlling shareholder. This tenancy falls under Listing Rules as a connected transaction. Details of the connected transaction are disclosed in the Directors' Report.

(b) Under a master agreement entered into between Tai Ping Carpets International Limited ("TPC") and the Company dated 22 March 2005, TPC agreed to supply carpets and all forms of floor coverings and to provide installation and related ancillary services on normal commercial terms to the Company and its subsidiaries (the "Group") for a period of three years commencing on the date of the agreement at an annual cap of **HK$8.5 million** (2005: HK$8.5 million). During the year the Group has committed to purchasing carpets for a gross consideration of **HK$6.1 million** (2005: HK$7.3 million). Bermuda Trust, the controlling shareholder of the Company, is interested in more than 30% of TPC's equity.

(c) The Peninsula Manila is owned by Manila Peninsula Hotel, Inc. ("MPHI" – a 40% associate of the Company prior to 3 March 2005). MPHI became a subsidiary on 3 March 2005 following the completion of an offer made to 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 amount of rent paid to Ayala under the lease during 2006 amounted to **HK$8.8 million** (March to December 2005: HK$7.4 million). This lease falls under Listing Rules as a continuing connected transaction. Details of this continuing connected transaction are disclosed in the Directors' Report.

34. Material related party transactions *continued*

(d) MPHI was granted unsecured banking facilities of up to Peso 70 million (approximately HK$9.9 million) by Bank of Philippine Islands ("BPI") based on normal commercial terms. Approximately 35% of BPI's equity is held by Ayala, and BPI is also an associate of an MPHI director. The maximum balance of loan owed by MPHI to BPI during 2006 amounted to Peso 15 million (approximately HK$2.4 million). The loan was fully repaid on 13 February 2006.

(e) Security and interest-free shareholder's loans amounting to **US$58.75 million (HK$458 million)** (2005: US$57 million (HK$445 million) were granted by Peninsula International Investment Holdings Limited ("PIIHL"), a wholly-owned subsidiary of the Company, to The Peninsula Shanghai (BVI) Limited ("TPS"), a 50% jointly controlled entity of the Group. The loans are unsecured, interest free and have no fixed terms of repayment. TPS holds a 100% direct interest in The Peninsula Shanghai Waitan Hotel Company Limited ("PSW"), a foreign owned enterprise incorporated in the People's Republic of China, engaged in the development of The Peninsula Shanghai project.

As at year end, shareholder's loans amounting to **US$36.75 million** (2005: US$35 million) was contributed as capital of PSW and the balance of **US$22 million** (2005: US$22 million) was on-lent by TPS to PSW on an interest-free basis for the purpose of funding the project.

In addition, under a Pre-Opening Design and Advisory Services Agreement dated 24 October 2006, HSH Management Services Limited ("HMS"), a wholly owned subsidiary of the Company, agreed to provide technical and design advisory services to PSW. Conditional upon the performance by HMS of its obligations under the agreement, PSW has agreed to pay services fees in the aggregate amount of US$1.17 million to HMS.

(f) The Company announced on 6 December 2000 that Kam Lung Investments Limited, a wholly owned subsidiary of the Company, entered into various agreements with the then independent third parties, including China Everbright Group Ltd. ("CEG") to carry out the restructuring of The Palace Hotel Co., Limited ("TPH"), the owner of The Peninsula Palace, Beijing. Upon completion of the restructuring under the terms of the agreement as announced, CEG was entitled to appoint two representatives as Directors of TPH's board consisting of nine members and to receive a priority payment of a minimum of RMB 8 million up to and including 11 November 2033 ("Annual Payment"). Completion of the restructuring took place on 13 December 2002 and the Annual Payment became payable. The Annual Payment in an amount of **RMB 8 million** was recorded in 2006 (2005: RMB 8 million).

35. Non-adjusting post balance sheet event

After the balance sheet date the Directors proposed a final dividend, the details of which are disclosed in note 12.

36. Key sources of estimation uncertainty

Notes 30(a) and 31 contain information about the assumptions and their risk factors relating to define benefit retirement obligations and financial instruments. Other key sources of estimation uncertainty are as follows:

Valuation of investment properties
Investment properties are included in the balance sheet at their open market value, which is assessed annually by independent qualified valuers, after taking into consideration the net income allowing for reversionary potential. The assumptions adopted in the property valuation are based on the market conditions existing at the balance sheet date, with reference to current market sales prices and the appropriate capitalisation rate.

Estimated useful lives of properties, plant and equipment
The Group estimates the useful lives of its properties, plant and equipment based on the periods over which the assets are expected to be available for use. The Group reviews annually their estimated useful lives, based on factors that include asset utilisation, internal technical evaluation, technological changes, environmental and anticipated use of the assets tempered by related industry benchmark information. It is possible that future results of operation could be materially affected by changes in these estimates brought about by changes in factors mentioned. A reduction in the estimated useful lives of properties, plant and equipment would increase depreciation charges and decrease non-current assets.

Asset impairment
The Group assesses the impairment of assets in accordance with the accounting policy set out in note 1(m). The factors that the Group considers important in assessing the impairment include the following:

- significant under performance relative to expected historical or projected future operating results;
- significant negative industry or economic trends.

Deferred tax assets
The Group reviews the carrying amounts of deferred taxes at each balance sheet date and reduces deferred tax assets to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilised. However, there is no assurance that the Group will generate sufficient taxable income to allow all or part of its deferred tax assets to be utilised.

37. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2006

Up to the date of issue of these Financial Statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for year ended 31 December 2006 and which have not been adopted in these Financial Statements.

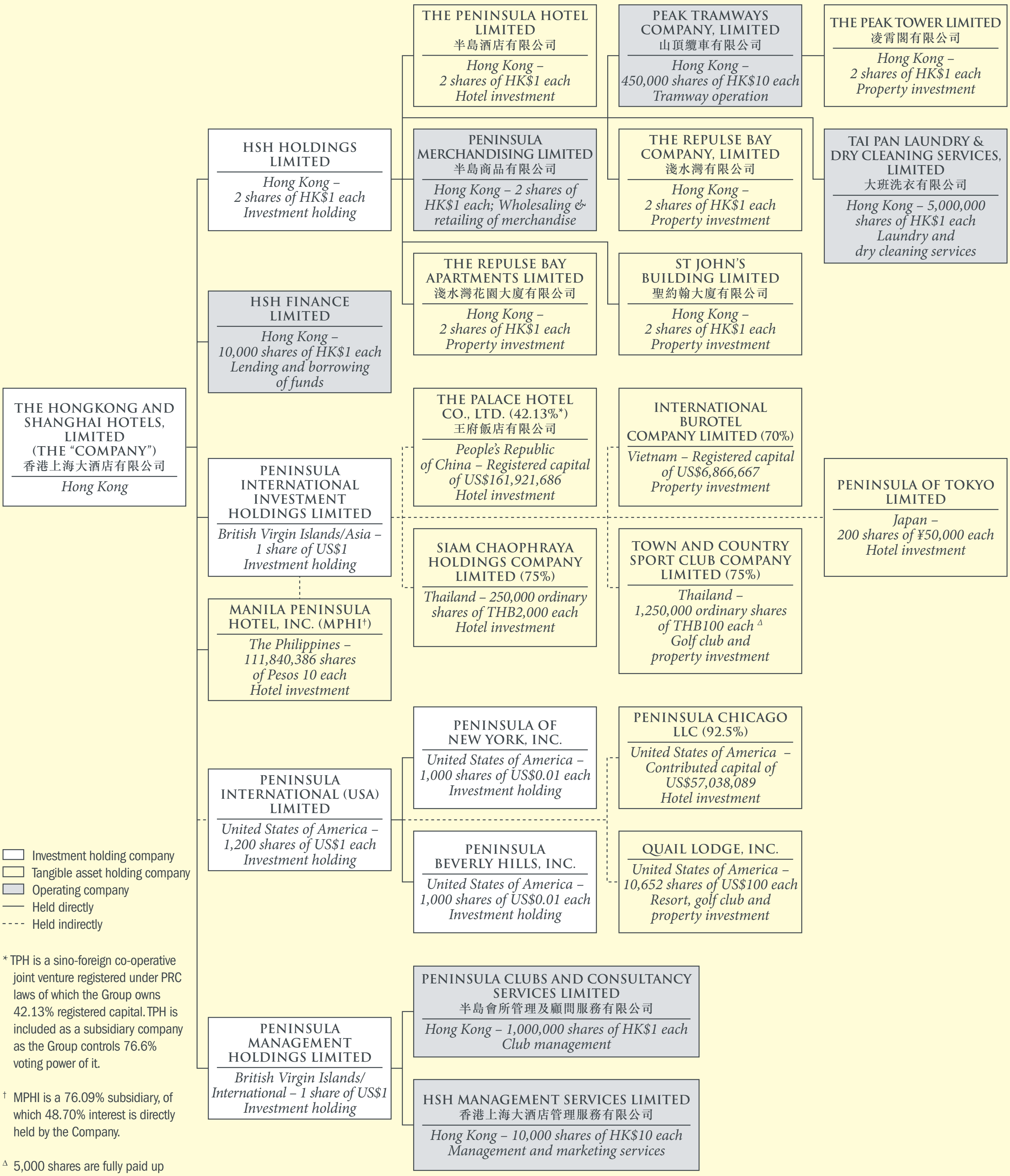
The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's operations results and financial position.

In addition, the following developments may result in new or amended disclosures in the Financial Statements:

	Effective for accounting periods beginning on or after
HKFRS 7, Financial instruments: disclosures	1 January 2007
Amendment to HKAS 1, Presentation of financial statements: capital disclosures	1 January 2007

Principal Subsidiary Companies

At 31 December 2006



* TPH is a sino-foreign co-operative joint venture registered under PRC laws of which the Group owns 42.13% registered capital. TPH is included as a subsidiary company as the Group controls 76.6% voting power of it.

† MPHI is a 76.09% subsidiary, of which 48.70% interest is directly held by the Company.

Δ 5,000 shares are fully paid up and the remaining 1,245,000 shares are partially paid up at THB25 each.

The principal subsidiaries in the Group at 31 December 2006 are shown opposite, with details of their place of incorporation and principal place of business respectively, the issued ordinary share capital/contributed capital/registered capital and main activities. All are 100% owned except where indicated. The Directors consider that a chart containing details of all subsidiaries would be of excessive length and complexity and therefore only the particulars of those subsidiaries which principally affect the results or assets of the Group are included.

Auditors' Report

Independent auditor's report to the shareholders of
The Hongkong and Shanghai Hotels, Limited 香港上海大酒店有限公司
(incorporated in Hong Kong with limited liability)

We have audited the consolidated Financial Statements of The Hongkong and Shanghai Hotels, Limited (the "Company") set out on pages 86 to 147, which comprise the consolidated and Company balance sheets as at 31 December 2006, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibilities for the Financial Statements

The Directors of the Company are responsible for the preparation and the true and fair presentation of these Financial Statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated Financial Statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

KPMG
Certified Public Accountants
8th Floor, Prince's Building, 10 Chater Road, Central, Hong Kong

15 March 2007

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The Company's registrars are Computershare Hong Kong Investor Services Limited, located at 46th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong

The Company's registered office is situated at 8th Floor, St. George's Building, 2 Ice House Street, Central, Hong Kong.

This annual report and other information about the Company's operations can be accessed by visiting www.hshgroup.com/ir, and any investor relations enquiries can be emailed to ir@hshgroup.com.

This annual report is printed on environmentally friendly, chlorine free paper.

Company Websites
HSH Corporate: *www.hshgroup.com*
The Peninsula Hotels: *www.peninsula.com*

DESIGNED AND PRODUCED BY LILIAN TANG DESIGN LIMITED

THE HONGKONG AND SHANGHAI HOTELS, LIMITED
香港上海大酒店有限公司