C

Four Seasons Hotels

1986 ANNUAL REPORT

"We can build aesthetically pleasing structures in the finest locations and appoint them with superior furnishings, but it is our people who are at the heart of our guests' satisfaction."

Isadore Sharp

TABLE OF CONTENTS

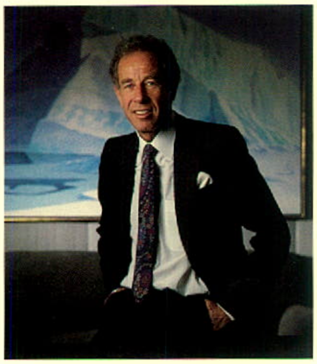
Four Seasons Hotels has created a market niche for itself within the hotel industry by specializing. It operates only medium-size hotels of exceptional quality. During its 25-year history, the company has built an enviable collection of hotels in Canada, England and the United States in locations almost impossible to duplicate today.

In 1986, Four Seasons marked the twenty-fifth anniversary of its founding by Isadore Sharp, the present Chairman and President. During 1986 and the first part of 1987, six new hotels were added, bringing the total hotels to 23, guest rooms under management to more than 7,250 and employees in excess of 9,000. Gross revenues under management for the year ended December 31, 1986 surpassed $500 million.

The company plans to continue its expansion in major business centres and resort locations, both in North America and internationally, in association with respected developers and financial institutions.

In a series of interviews with the members of the management committee of Four Seasons Hotels a number of questions were raised which we think will interest you, our shareholders. Our response to these questions is contained in the pages which follow.

But first, I wish to acknowledge the great contribution of four groups of people who are critical to our success: our shareholders who share our vision of the future; our partners who help make our dream a reality; our customers who understand the value of what we offer; and our more than 9,000 employees who strive to deliver service that is consistently excellent. These are our four cornerstones, the very foundation of Four Seasons Hotels.



I would also like to present our 1986 highlights to you:

- □ Our earnings of $9,515, 000 were double those of 1985
- □ The return on shareholders' equity exceeded 21%
- □ The public offering and corporate restructuring which were completed during 1986 strengthened the company's financial position. Our debt to equity ratio, net of cash and short-term investments, is now 0.65:1
- □ We opened three new hotels: the Four Seasons Newport Beach, California; the Four Seasons Hotel and Resort in Dallas at Las Colinas; and the Four Seasons Austin, Texas
- □ Construction continues on schedule on the Four Seasons Hotel, Los Angeles (which should be open by the time you read this) and on our second hotel in Chicago, the Four Seasons, which will open in 1989
- □ We acquired the historic Biltmore resort hotel at Santa Barbara, California on April 1, 1987 and just recently signed a letter of intent to manage a 14-acre beachfront resort hotel to be built on the Hawaiian island of Maui.

This has been a very productive year and we are confident that we have taken the necessary steps to ensure our continued success in 1987 and beyond.

Isadore Sharp, Chairman and President

FINANCIAL HIGHLIGHTS

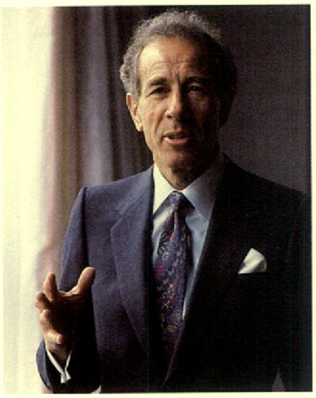
(Thousands of dollars)	**Actual 1986**	Forecast 1986	Actual 1985
Total revenues of all managed hotels	**$509,314**	517,386	440,514
Net earnings	**$ 9,515**	8,813	4,657
Funds generated from continuing operations	**$ 22,885**	23,232	14,345


JANET

"Now that we're in most major North American cities, we'll make our name the generic term for luxury hotels by 1990."

Isadore Sharp, Chairman and President

What position does Four Seasons occupy in the hotel industry?



Isadore Sharp: We believe that we are now recognized throughout the hotel industry in North America as the leading operator of luxury hotels. Other hotel companies tell us that we are the standard by which luxury hotels are judged. It's taken us years to accomplish this; in 1986 we marked our twenty-fifth anniversary.

I think we achieved this position because we've specialized. Rather than trying to cover all segments of the travel market, we've concentrated on providing business executives and professionals with an environment which allows them to operate at peak efficiency. They tell us that being able to depend on the high level of our service, and more importantly on its consistency, is of very real value and enables them to be more productive on a business trip.

Isn't the luxury hotel market a risky place to be?

Roger Garland, Executive Vice-President, Development, Finance and Administration: Not really. Although the luxury hotel market is the smallest segment, it is one of the fastest growing and historically has been the most stable. Our customers are intensely loyal which gives us a solid business base. We're continually refining our product in order to build on that loyalty and attract new customers. Still, we can't afford to be complacent.

John Young, Senior Vice-President, Human Resources: It can be risky if you're not totally dedicated to quality and service. We don't believe you can be a part-time luxury hotel operator and succeed. For example, the greater care we take in selecting, training and developing our staff enables us to deliver the service we promise.

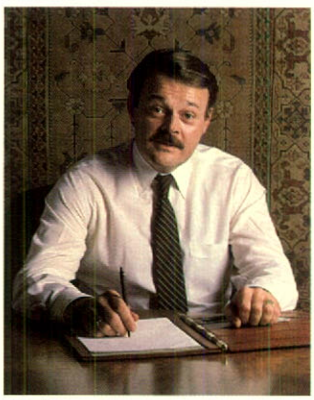
How vulnerable is Four Seasons to competition from larger hotel companies?

John Sharpe, Executive Vice-President, Operations: We don't believe that large hotel chains can stay as close to their customers. Listening to our guests, for example, is one of our main information sources. Our general managers know our regular clients by sight and by name . . . and know their likes and dislikes. We stay on top of this with our guest history data system and that enables us to provide a very personal service.

John Young: That's one of the reasons we won't let ourselves grow too large, too fast. We don't want to lose that personal contact.

Robert Bloch, Senior Vice-President, Marketing: Actually, we've got the best of both worlds. Small enough to be personal, big enough to conduct sophisticated research regularly both among our current customers and non-users in our target group.

You talk a lot about the distinctiveness of your hotels. Does the business traveller really see the difference?



Jim Brown

Jim Brown, Senior Vice-President, Operations: Guests tell us in their letters and comments that they do, but the most tangible way we know is by the high level of repeat visits that our guest history system records.

Chris Wallis, Senior Vice-President, Design and Construction: There's a good reason for their loyalty. It's called value. The seasoned business traveller works long hours, under pressure, away from family and friends. We provide our guests with a comfort level which helps them to be at their best.

Robert Bloch: I think Jim and Chris are right. But we also know that many potential customers don't know us and therefore don't see the difference. We're going after this group with a bigger and bolder marketing thrust. To get more people to try our hotels we need to ensure that they understand what our regular clientele already know . . . that we provide better value.

Roger Garland: Also, let's not confuse luxury with excess. Our guests have come to rely on our attention to small details in the service we provide and because of it, they appreciate the difference between Four Seasons and other hotels.

What makes Four Seasons attractive to investors?

John Sharpe: We have achieved a well defined, strongly entrenched position in an expanding market. We're single-minded in purpose and are committed to steady, long-term growth.

Roger Garland: We have a well-balanced portfolio of management contracts and hotel equity investments which offer the investor the long-term prospect of sustained earnings growth and capital appreciation.

Isadore Sharp: We're dealing from a position of strength. Four Seasons is a stable company with a proven track record. We have the financial resources, reputation and experience to capitalize on the best growth opportunities. We also have an exceptionally committed group of employees who keep us in touch with our customers and protect our business base.

Where will Four Seasons look for growth?

John Sharpe

John Sharpe: Growth over the next three to five years will come from more aggressive marketing in North America, taking advantage of our brand awareness to improve occupancy rates, as well as from carefully-selected acquisition and management contract opportunities.

Jim Brown: Young, aspiring managers and professionals are a group that is growing rapidly and will be a big part of our future clientele. The 50-plus group is another affluent segment that is growing. We must make them feel welcome at our hotels and be responsive to their needs.

Chris Wallis: We continue to seek the right opportunities for expansion in Europe and the Far East. We have a lot of attractive proposals presented to us, but we will only expand where the situation is complementary to our existing product line.

Robert Bloch: We already have a loyal base of customers who insist on Four Seasons when travelling on business. They have the same high level of service expectation on vacation, so a logical growth opportunity is the resort market. We're actively pursuing luxury resorts in destinations that are popular with our customers, like Hawaii and Southern California.

Does Four Seasons have the depth of management to compete effectively in the future?

Jim Brown: Absolutely. Our executives are hands-on managers. They pay a lot of attention to the management of people, details of product delivery, and bottom-line results. We're our own toughest critics. Within the management group there's a balanced mix of optimism and conservatism. You need that kind of open-minded, give-and-take atmosphere to get the best results.

Isadore Sharp: The sense of judgement among our top managers is superb. We share a similar set of principles and a common purpose that stimulates trust and respect. In this atmosphere, there is tremendous co-operation and help given each other.

John Young: Management development is an ongoing process. The general managers of our hotels hire and develop the best possible people. This ensures we'll continue to have a pool of talented, experienced individuals to fill key management positions in the future. We've achieved an enviable reputation within the hotel industry as a desirable employer.

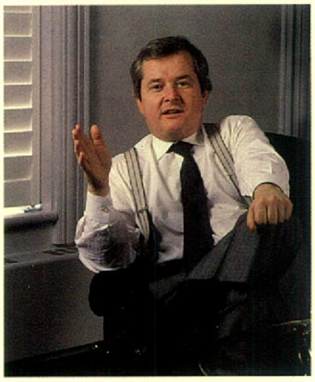
What is your vision of the future?

Isadore Sharp: It doesn't differ greatly from the present. Good growth will be possible simply by attracting more customers to our existing hotels. We'll continue to refine our basic product and we'll introduce variations to expand our service to the increasingly important leisure and conference markets. We won't diversify into new products that are outside our main customer base. A stronger brand identity and even better product should result in continued financial success for investors and employees, and good value for our guests.

"Relentless self-examination is the key to improving performance. We learn not only from our customers and employees but also our competitors. No one has a monopoly on good ideas."

John Sharpe, Executive Vice-President, Operations

From an operations viewpoint, how well did Four Seasons perform in 1986?



John Sharpe: The company had a very satisfying year in 1986. Most of our properties achieved improved levels of occupancies and profit margins and where we had problems we responded effectively. We also successfully opened three new hotels.

John Young: Employee response to the opportunities and problems of 1986 has been outstanding. Personal initiatives have resulted in novel, effective ways of containing costs while maintaining or improving service and quality. These ideas helped us to be even more competitive in 1986, and represent an attitude that should contribute towards improving our profit in 1987 and beyond.

Robert Bloch: Part of our success in 1986 is a function of doing a better job of communicating with our customers. We launched a new advertising campaign that's helping to build top-of-mind awareness of Four Seasons as *The* North American luxury hotel. We've also computerized our central reservations system with customized software to better serve the specific needs of our customers.

What are your greatest operational strengths?

Isadore Sharp: Dedicated people. It's taken us 25 years to build and co-ordinate our team. No one can duplicate that overnight.

How can you train 9,000 employees in 23 locations to deliver "personal" service?

Jim Brown: It starts with the hiring process. Personality and attitude are even more important than experience. If you hire an individual who's motivated and interacts well with people, it's easy to develop training programs that teach specific skills. The reverse, however, is not true.

John Young: We recognized long ago that our employees wanted and needed better training. We developed specific training courses for each department, which have had a dramatic impact on staff morale and the overall level of our service.

John Sharpe: Management by example: actions speak louder than words.

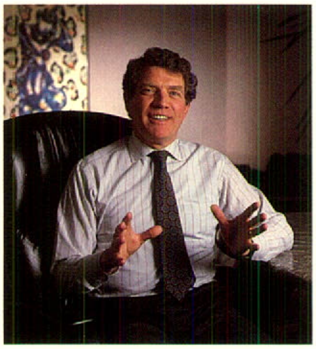
Which areas of Four Seasons' operations are weakest? What is being done to improve them?

John Sharpe: Too many people in our target markets still don't know who we are. And too few people know that The Pierre in New York and The Ritz-Carlton in Chicago are Four Seasons hotels. We must build a stronger brand recognition of the name Four Seasons and awareness that it stands for quality and service in the luxury hotel market. Our new advertising campaign and expanded regional sales office network helped in this regard.

Jim Brown: The consistency of our service is still not as high as we'd like. In 1987 we'll focus on delivering our product with zero defects at each one of our hotels. If everything is done right, then we're unbeatable.

Robert Bloch: Attracting group and local business is particularly important in over-supplied markets. We're emphasizing sales and marketing efforts to secure groups, as well as maintaining the calibre of our food and beverage services to attract local customers.

In view of its economy, what is the explanation for Four Seasons' continuing involvement in the Texas market?



Roger Garland

Roger Garland: We reduced our financial exposure in the Texas market during 1985. Then, in December 1986 we also sold our management contract for The Mandalay Hotel in Dallas to allow us to concentrate on the Las Colinas Inn and Conference Center which we've renamed the Four Seasons Hotel and Resort. Our five Texas hotels are top quality properties. They are all well located and in the best cities in the state. In a normal economy they would be extremely successful. The owners realize the long-term potential of their investment and we see Texas as an important ongoing contributor to our earnings.

Jim Brown: There are good business reasons for being in Texas. We're optimistic about our new hotel in Austin, which is the most stable market in Texas. Dallas, Houston and San Antonio are attractive markets when over-supply is not a problem. In Houston for example, the convention centre that's opening in 1988 has already produced a lot of bookings.

Now that the Expo '86 boom is over, what will happen to the Vancouver Four Seasons hotel?

Robert Bloch: Expo turned out even better than we expected but the Vancouver market is seriously over-supplied. We still have the best downtown location and an exceptional local food and beverage business.

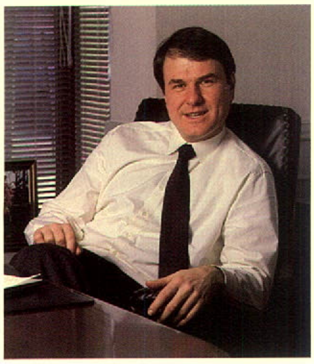
Jim Brown: We are maintaining our market share and the new west coast convention centre should boost traffic. Also, Expo created a heightened awareness of Vancouver as an exciting destination and this should encourage even more traffic in the future.

How was your London hotel affected by European terrorist activity?

John Sharpe: Hardly at all, because of two factors: customer loyalty and management response. We directed advertising to attract more European business, replacing North American tourists who cancelled their European trips. For many years our London hotel has maintained a remarkable leadership position. 1986 was no exception.

Chris Wallis: The Inn on the Park has been internationally acclaimed as one of the world's finest hotels. Its reputation, staff, and desirability as the place to stay in London has allowed the hotel to prosper despite the threat of terrorism, just as it did during the 1982 recession and the oil crisis of the early 1970s.

What makes you think Four Seasons can be successful in the resort business?



Robert Bloch

Robert Bloch: The guests who stay at our hotels vacation in magnificent resort settings like Hawaii and Southern California. Surprisingly, superior vacation accommodations and services at these locations are in extremely short supply. The resort market is expanding rapidly and we know the discerning traveller appreciates the Four Seasons experience as much during holidays as during a business trip.

Chris Wallis: Our emphasis on excellence is even more important to the vacationer, who spends more time within the facility and actually uses a wider range of services. Our resorts will offer all the amenities and service of a Four Seasons hotel, features not found even in the best resorts.

John Sharpe: The new Four Seasons adjacent to Beverly Hills will be a great market builder for the resort we're opening in Hawaii. There's a tremendous volume of traffic between California and the islands, and now that we have four hotels in California, prospective guests will be able to get acquainted with our style while still at home. Then too, our recent acquisition of the Santa Barbara Biltmore gives us the opportunity to expose a Four Seasons-style resort to current clientele.

Will there be any major operational changes in 1987?

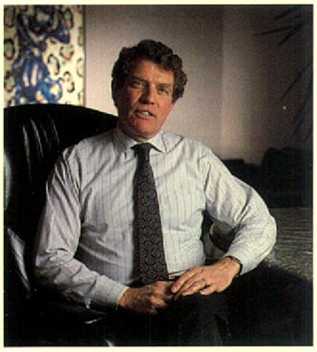
John Sharpe: Major operational changes? No. But of course, we will continue to refine the product we now offer and we'll remain responsive to market conditions.

"From a financial and strategic standpoint, we're in a better position than ever to pursue profitable growth opportunities in resort markets and major cities world wide."

Roger Garland, Executive Vice-President, Development, Finance and Administration

---

A lot happened in 1986. What were the most noteworthy events in terms of development and finance?



Roger Garland: Our financial performance was excellent. In 1986 we doubled our net earnings. The public share offering raised $33 million of equity capital. The combination of the public share issue, our corporate restructuring and internally generated cash flow allowed us to reduce our debt by over $54 million. As a result, our debt to equity ratio, net of cash and short-term investments, is 0.65:1, placing us in an excellent position to finance future growth opportunities.

Chris Wallis: This was a busy year for development. We opened hotels in Newport Beach, Dallas and Austin. And we are almost ready to open another, in Los Angeles. We've entered into a letter of intent to manage our first resort hotel in Hawaii, on the island of Maui. We also purchased Minaki Lodge in Northern Ontario from the provincial government and we've just acquired the historic California resort, the Santa Barbara Biltmore.

You've talked for some time about expanding in Europe and the Far East, but there seems to be no progress. What's the problem?

Isadore Sharp: The grand hotels of Europe and the Orient are excellent but these markets are presently over-supplied. We've established the right financial and development contacts and they are constantly monitoring industry conditions. We're patient and we're being very selective. With our overseas joint venture partner, Kuo Investments, we're well-positioned to move quickly when suitable opportunities arise.

Roger Garland: In Europe, growth may come through acquisitions as old family businesses change hands. We've strengthened our balance sheet, increased our cash reserves and debt capacity to allow us to take advantage of such opportunities.

What makes you attractive to hotel and resort developers?

Chris Wallis

Chris Wallis: We believe that the Four Seasons name and product adds value to any real estate development. Many of our newer hotels are part of multi-use complexes such as those in Philadelphia and our second hotel in Chicago, which we'll open in 1989. The Ritz-Carlton Hotel in Chicago which we took over ten years ago is part of an enormously successful mixed-use project. Owners say that the Four Seasons presence enhances the other components of the development.

John Sharpe: Owners get long-term capital appreciation, steady revenue flow and the confidence that comes from dealing with a stable, knowledgeable organization. Access to our top people is immediate. There's no bureaucracy to wade through. We have a commitment to keeping our organization lean. We want to maintain our direct contact with our customers, our employees and our partners. This gives us the ability to make decisions quickly.

John Young: It's hard to find an operator who pays attention to detail the way we do. We have the flexibility and tight controls needed to manage costs effectively, without compromising quality. We look for partners who share our attitude and commitment to excellence.

Roger Garland: Hotels are extremely expensive to build today, so developers can't afford any mistakes. Our track record speaks for itself.

How will Four Seasons use the funds currently being generated by operations?

Roger Garland: Basically three ways: one, to finance the growth we have planned over the medium-term; two, to invest in our existing hotels to maintain the quality of their facilities; and three, to provide a return to our shareholders.

Your equity interests in hotels range from 100% to zero.
What's the investment policy with respect to future opportunities?

Isadore Sharp: Each opportunity is evaluated on its own merits. Our investment tactics are not fixed. We're open to the acquisition of existing facilities, as well as new development. We're prepared to take an equity position or be strictly operators, depending on the requirements of the situation. And although we will continue to control our financial exposure in any single investment, we do believe in the long-term residual value of quality real estate.

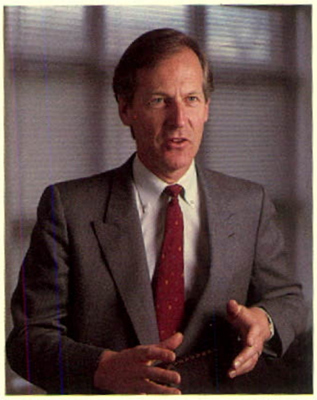
Roger Garland: In North America the trend will be for us to operate hotels with a minority equity participation. We also participate in the benefits of ownership through the incentive fees in our management contracts. Our strong balance sheet, however, ensures the availability of capital for investment in high-quality ventures in Europe and the Far East, where the best opportunities may involve acquisiton of existing hotels.

How will U.S. tax reform affect you?

Chris Wallis: Unquestionably it will help us. New hotel development has been curtailed in the U.S. because of the Tax Reform. New properties will no longer be built for tax reasons. They will have to make economic sense. This will make our existing hotels more valuable as demand catches up to supply and a normal balance is restored. The tax changes may force the sale of some hotels, which could make attractive acquisition opportunities available.

John Sharpe: The business entertainment tax legislation, as it's now written, shouldn't hurt us. But if we hadn't acted when we did, we could have had a problem. We lobbied hard to block a proposal that would have set strict limits on room rate deductibility as well as severe dining entertainment restrictions. Four Seasons employees wrote over 4,000 letters to their Congressmen and United States Senators expressing their concern. We believe their message helped.

What determines how much additional growth Four Seasons can safely manage?



John Young

John Young: We can handle growth easier today than we could have five or ten years ago. We have greater management depth and a broader base of employee talent to draw on, as well as a solid reputation among developers and financiers.

Roger Garland: Financially, Four Seasons is capable of orderly expansion, while still keeping its debt/equity ratio within acceptable limits. Also, we now have sufficient experienced management and line employees to open one to two new hotels each year.

Chris Wallis: We're already in the major North American centres we feel are essential to our product distribution so growth in urban hotels will come through ventures in Europe and the Far East, as well as a few selected North American cities. The potential for resort development is practically unlimited. We hope to follow Hawaii with resorts in other prime destinations both in North America and internationally.

Isadore Sharp: Balanced growth is the key to our success. We're not risk-averse. We will not, however, participate in any new project that could compromise our existing operations or jeopardize the financial stability of the company.

What can shareholders expect to gain from their investment in Four Seasons over the coming years?

Roger Garland: I can't predict what the stock market will do. However, I can say that we are committed to a program of well planned growth and the financial performance which must evolve from this growth. We're determined to become as well known for the quality of our financial performance as we are for the quality of our hotels.

In 1986 all our key financial targets were met or exceeded. The 1986 earnings of $9,515,000 were more than double 1985 earnings and exceeded the earnings forecast included in our January 1986 prospectus by 8%. The company's return on equity was 21.6%, the debt to equity ratio, net of cash and short-term investments, strengthened significantly to 0.65:1 and funds generated from continuing operations were $22,885,000 up 60% from 1985.

Financial Strategy

The company's financial strategy is built on a program of carefully planned growth and a commitment to quality financial achievement. Our objective is to achieve reasonable balance between the management and the hotel ownership segments of our business. While our hotel management operations provide a long-term source of stable, predictable earnings and cash flow, hotel ownership operations in major markets provide the financial leverage for significant earnings and cash flow as well as participation in the long-term potential increase in the value of the real estate.

In 1986 hotel management operations represented 56% of our total earnings. Our hotel management contracts are long-term with an average remaining term, including option periods, of 59 years. These contracts provide monthly fees which are primarily based on the gross operating revenues of each hotel and most also provide for incentive fees which are a profit participation in the hotels' net earnings. As the hotels mature, our incentive fees become a more important profit contributor.

The hotel ownership operations accounted for 44% of our 1986 earnings. Our investments in quality locations in some of the world's major financial centres provide the opportunity for earnings leverage and long-term capital appreciation. Our equity partners are some of the most substantial developers and financiers in North America and the Far East. This provides added financial stability and contributes to the long-term success of a project.

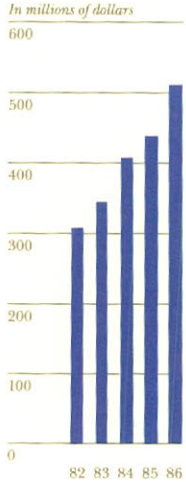
OPERATING RESULTS

Hotel Management Operations

We expanded the base of our hotel management business during 1986 through the openings of three Four Seasons hotels in Newport Beach, California (June), Dallas at Las Colinas, Texas (July), and Austin, Texas (December). These openings and the strong operating results in our primary markets increased the total revenues of all managed hotels by 16% to $509 million and fee revenues by 19% to $27.8 million. Fee revenues have increased at a compound annual growth rate of 22% since 1982. During the same period, earnings increased from 29% of fee revenues to 46% in 1986.

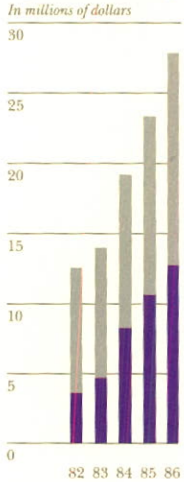
Total Revenues of All Managed Hotels

In millions of dollars



Hotel Management Operations-Earnings

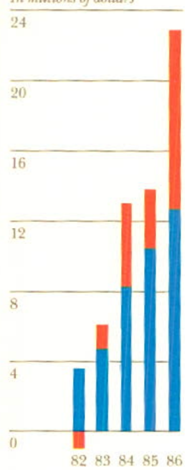
In millions of dollars



Fee Revenues
Earnings Before Interest and Taxes

Earnings From Continuing Operations Before Interest and Taxes

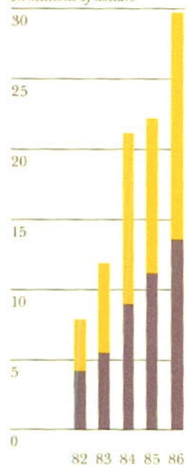
In millions of dollars



Hotel Ownership Operations
Hotel Management Operations

Funds From Continuing Operations Before Interest and Taxes

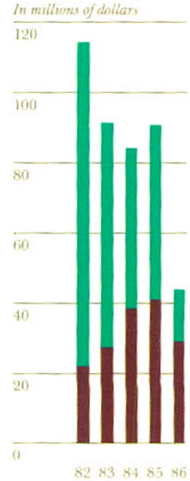
In millions of dollars



Hotel Ownership Operations
Hotel Management Operations

Balance Sheet Review

In millions of dollars



Total Debt, Net of Cash
Total Equity

The Texas hotels, which accounted for 17% of our total fee revenues in 1986, were affected by the poor economic conditions resulting from the drastic drop in world oil prices. However, the fee shortfalls were more than offset by strong occupancy and rate gains in other key markets and by strong foreign exchange rates. Fee revenues as a percentage of total revenues of all managed hotels increased to 5.5% in 1986 as a result of the growth in incentive, purchasing and development fees. Our 13 hotels in the U.S. represented 65% of our total fee revenue in 1986.

Additional revenue growth is anticipated in 1987 from the full-year operations of the hotels which opened in 1986 along with the 1987 openings of the Four Seasons Los Angeles and the Four Seasons Biltmore at Santa Barbara, California. The disposal of our management contract on the Dallas Mandalay hotel at the end of 1986 will have a moderate offsetting effect. The costs of management operations are expected to increase only moderately despite the addition of five hotels in 1986 and 1987.

Hotel Ownership Operations

This business segment includes those hotel investments in which the company owns at least 20% of the project. There are five wholly owned or leased properties: London, New York, Vancouver, Four Seasons Toronto and Minaki Lodge. The proportionate consolidation of Chicago, Edmonton and Ottawa is also included.

Hotel ownership earnings increased substantially in 1986 to $10.2 million, more than triple our 1985 earnings. A successful Expo '86 generated a strong increase in both rate and occupancy at the Four Seasons Vancouver. The Pierre in New York realized strong gains as a result of a full year with the major restoration program completed and the absence of the New York City labour difficulties caused in 1985 by the month-long hotel workers' strike. Also, strong sterling and U.S. dollar exchange rates favourably impacted the 1986 earnings.

Despite the severe impact of terrorism on the London hotel market, the Inn on the Park maintained its outstanding operating performance through quick and decisive management action to counteract the effect of the significant drop in North American travellers to London. These steps combined with careful management of operating costs and rate increases, allowed the hotel to continue to make a significant contribution to earnings.

Continued revenue growth in hotel ownership activities in 1987 is expected to result from occupancy and rate gains in our major markets as well as from the acquisitions of a 50% interest in the Santa Barbara Biltmore in March 1987 and a 100% interest in Minaki Lodge, a seasonal resort in Northern Ontario. We expect some offset from an anticipated soft year in Vancouver. A major capital renovation program planned for the Santa Barbara Biltmore will commence in late 1987 and continue through 1988. The acquisition and renovations of the Santa Barbara hotel will be financed by a non-recourse first mortgage, a term bank loan and from the company's internally generated cash flow. Upon completion of the program it is anticipated that the Santa Barbara hotel will make a significant earnings contribution.

Balance Sheet

The public offering of subordinate voting shares and the corporate restructuring which were completed in February 1986, along with cash generated from operations enabled the company to reduce its debt by $54 million and to increase its cash reserves to $14 million. The debt to equity ratio, net of cash and short-term investments, strengthened to 0.65:1, well below the company goal of 1:1. This significant reduction of debt allowed net interest costs to fall to $4.8 million. These interest costs still exceeded our forecast, however, due to higher sterling exchange rates on our U.K. debt and lower than anticipated interest rates on our invested cash reserves.

The corporate restructuring eliminated certain assets and liabilities identified as extraneous to the company's principal business. These net assets were distributed through the redemption of certain shares and the reduction of retained earnings. The restructuring was followed by the public offering of 2,367,857 subordinate voting shares which produced gross proceeds of $33 million.

The funds generated from operations in 1987 will be reinvested to improve existing facilities, used for future investment opportunities and will provide a return to our shareholders.

Summary

The performance of 1986 has confirmed the financial capability of the company. A solid capital base has been established and the cash flow generated will satisfy normal operating and capital needs. The company is well-positioned financially to take full advantage of growth opportunities which present themselves in the future.

Years Ended December 31 ($ 000's)	1986	1986 Forecast (unaudited)	1985	1984	1983	1982
Hotel Management Operations						
Total revenues of all managed hotels	**$ 509,314**	517,386	440,514	405,141	347,512	304,420
Fee revenues	**$ 27,822**	26,266	23,397	19,047	13,996	12,569
Expenses						
—General and administrative	**14,260**	12,654	12,157	10,060	8,568	8,408
—Depreciation and amortization	**796**	743	594	819	623	462
Earnings before interest and taxes	**12,766**	12,869	10,646	8,168	4,805	3,699
Hotel Ownership Operations						
Revenues	**175,728**	166,459	148,809	142,730	103,764	97,307
Expenses						
—Cost of sales and expenses	**150,276**	143,879	130,772	124,646	92,743	89,563
—Fees to Hotel Management Operations	**8,893**	8,085	7,303	6,916	4,779	4,230
—Depreciation and amortization	**6,399**	7,180	7,546	6,324	4,942	4,556
Earnings (loss) before interest and taxes	**10,160**	7,315	3,188	4,844	1,300	(1,042)
Earnings from continuing operations before interest and taxes	**22,926**	20,184	13,834	13,012	6,105	2,657
Loss (earnings) from discontinued operations before interest and taxes	**(47)**	—	340	2,092	3,153	(7,027)
Interest, net	**4,846**	3,345	6,400	7,966	8,383	14,436
Earnings (loss) before income taxes	**18,127**	16,839	7,094	2,954	(5,431)	(4,752)
Income taxes						
—Current	**1,940**	1,530	1,483	1,054	84	314
—Deferred (recoverable)	**6,672**	6,496	2,162	1,463	(1,995)	(3,026)
	8,612	8,026	3,645	2,517	(1,911)	(2,712)
Earnings (loss) before extraordinary items	**9,515**	8,813	3,449	437	(3,520)	(2,040)
Extraordinary items	—	—	1,208	4,730	9,166	—
Net earnings (loss)	**$ 9,515**	8,813	4,657	5,167	5,646	(2,040)
Funds from continuing operations before extraordinary items	**$ 22,885**	23,232	14,345	12,097	3,465	(6,813)

Note: The Corporation's prospectus dated January 21, 1986 with respect to the offering of Subordinate Voting Shares included a forecast consolidated statement of operations for the year ending December 31, 1986.

CONSOLIDATED STATEMENT OF OPERATIONS

Year Ended December 31, 1986 ($ 000's)	1986	1985
Hotel Management Operations		
Total revenues of all managed hotels (note 1(a))	$ 509,314	440,514
Fee revenues (note 1(g))	$ 27,822	23,397
Expenses—General and administrative	14,260	12,157
Depreciation and amortization	796	594
Earnings before interest and taxes	12,766	10,646
Hotel Ownership Operations		
Revenues	175,728	148,809
Expenses—Cost of sales and expenses	150,276	130,772
Fees to Hotel Management Operations (note 1(g))	8,893	7,303
Depreciation	4,505	4,160
Amortization	1,894	3,386
Earnings before interest and taxes	10,160	3,188
Earnings from continuing operations before interest and taxes	22,926	13,834
Loss (earnings) from discontinued operations before interest and taxes (note 12)	(47)	340
Interest, net (note 8)	4,846	6,400
Earnings before income taxes	18,127	7,094
Income taxes (note 10)—Current	1,940	1,483
—Deferred	6,672	2,162
	8,612	3,645
Earnings before extraordinary items	9,515	3,449
Extraordinary items (note 14)	—	1,208
Net earnings	$ 9,515	4,657
Earnings per share (note 15)		
Earnings before extraordinary items (1985 pro-forma basis)	$ 0.99	0.54
Net earnings (1985 pro-forma basis)	$ 0.99	0.67

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at December 31, 1986 ($ 000's)	1986	1985
ASSETS		
Current assets:		
Cash and short-term investments	$ 14,090	4,061
Receivables (note 2)	18,791	17,679
Inventory	2,493	2,611
Prepaid expenses	2,685	1,551
Total current assets	38,059	25,902
Prepaid rent (note 3)	3,165	3,427
Notes and mortgages receivable (note 4)	12,073	8,944
Investments in hotel partnerships and managed hotels (note 5(a))	10,014	10,021
Fixed assets (note 6)	74,133	72,135
Others assets	4,911	2,180
Discontinued assets (note 12)	—	59,111
	$ 142,355	181,720

CONSOLIDATED BALANCE SHEET

As at December 31, 1986 ($ 000's)	1986	1985
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 33,854	26,794
Long-term debt due within one year	1,417	18,942
Total current liabilities	35,271	45,736
Long-term debt (note 7)	41,179	51,230
Deferred income taxes	21,951	17,286
Preferred shares of a subsidiary	—	3,794
Liabilities related to discontinued assets (note 12)	—	21,749
Shareholders' equity: (note 9)		
Capital stock	38,971	8,028
Contributed surplus	4,685	4,685
Retained earnings	2,835	30,491
Equity adjustment from foreign currency translation	(2,537)	(1,279)
Total shareholders' equity	43,954	41,925
Contingencies and commitments (notes 11, 12 and 13)		
	$ 142,355	181,720

Approved on behalf of the Board of Directors:

Director Benjamin Swirsky

Director [illegible]

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH PROVIDED BY OPERATIONS

Year Ended December 31, 1986 ($ 000's)	1986	1985
Cash provided by (used in) operations		
Hotel Management Operations	$ 13,562	11,240
Hotel Ownership Operations	16,109	10,988
Discontinued Operations (note 12)	34	103
Interest	(4,846)	(6,400)
Current taxes	(1,940)	(1,483)
Working capital from operations	22,919	14,448
Change in non-cash working capital applicable to operations excluding current portion of long-term debt	5,197	(2,031)
Cash provided by operations	$ 28,116	12,417
Hotel Management Operations		
Earnings before interest and taxes	$ 12,766	10,646
Add items not requiring an outlay of funds:		
Depreciation and amortization	796	594
Working capital provided by hotel management operations	$ 13,562	11,240
Hotel Ownership Operations		
Earnings before interest and taxes	$ 10,160	3,188
Add (deduct) items not requiring (providing) an outlay (inflow) of funds:		
Depreciation and amortization	6,399	7,546
Amortization of prepaid rent	262	262
Foreign exchange gain	(426)	(248)
Equity (gain) loss on investments	(286)	240
Working capital provided by hotel ownership operations	$ 16,109	10,988

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year Ended December 31, 1986 ($ 000's)	1986	1985
Cash provided by (used in)		
Operations	$ 28,116	12,417
Financing	(997)	2,615
Capital Investments	(16,373)	(15,693)
Shareholder Distributions	(738)	(46)
Increase (decrease) in cash	10,008	(707)
Increase in cash due to unrealized exchange gain	21	748
Cash and short-term investments, beginning of year	4,061	4,020
Cash and short-term investments, end of year	$ 14,090	4,061
Financing		
Long-term debt, including current portion, issued	$ 3,769	23,221
Long-term debt, including current portion, repaid	(30,693)	(25,834)
Redemption of preferred shares of a subsidiary	(4,007)	—
Redemption of shares	(75)	(745)
Issuance of Multiple Voting and Subordinate Voting shares, net of costs (note 9)	32,032	—
Issuance of other shares (note 9)	—	5,973
Reduction of deferred income taxes	(2,023)	—
Cash (used in) provided by financing	$ (997)	2,615
Capital Investments		
Net (increase) reduction:		
Mortgages and long-term receivables	$ (4,456)	(6,089)
Real estate, hotel and other investments	(1,059)	(2,266)
Proceeds on sale of hotel investments	808	6,463
Proceeds on sale of other investments	—	745
Purchase of fixed assets	(8,681)	(13,810)
Other assets	(2,985)	(736)
Cash used in capital investments	$ (16,373)	(15,693)
Shareholder Distributions		
Dividends	$ (738)	(46)
Reorganization transaction (note 12):		
Discontinued assets	60,385	—
Liabilities related to discontinued assets	(23,152)	—
Redemption of shares	(37,233)	—
Cash used in shareholder distributions	$ (738)	(46)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Year Ended December 31, 1986 ($ 000's)	1986	1985
Retained earnings, beginning of year	**$ 30,491**	26,405
Net earnings for the year	**9,515**	4,657
Reorganization transaction (note 12)	**(36,220)**	—
Dividends on special shares	**(738)**	(46)
Redemption of shares	**(213)**	(525)
Retained earnings, end of year	**$ 2,835**	30,491

See accompanying notes to consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of Four Seasons Hotels Inc. is responsible for the preparation and integrity of the financial statements and related financial information of the company. The consolidated financial statements, notes and other financial information included in the Annual Report were prepared in accordance with accounting principles generally accepted in Canada. The statements also include estimated amounts based on informed judgement of current and future events. These estimates are made with appropriate consideration of the materiality of the amounts involved. The financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

Management maintains an extensive system of internal controls and budgeting procedures which are designed to provide reasonable assurance that assets are safeguarded and transactions are executed and recorded in accordance with management's authorization. To augment the internal control system, the company maintains a comprehensive program of internal audits covering all aspects of the company's operations.

The financial statements are reviewed and approved by the Board of Directors, which oversees management's reporting responsibilities through the Board-appointed Audit Committee. Peat, Marwick, Mitchell & Co., the independent auditors appointed by the shareholders of the company, have examined the financial statements in accordance with generally accepted auditing standards and their report follows. The shareholders' auditors and the Director of Internal Audit have full and free access to the Audit Committee to discuss audit findings, financial reporting and other related matters.

Isadore Sharp,
Chairman and President

H. Roger Garland,
Executive Vice-President

AUDITORS' REPORT

To the Shareholders of Four Seasons Hotels Inc.

We have examined the consolidated balance sheet of Four Seasons Hotels Inc. as at December 31, 1986 and the consolidated statements of operations, cash provided by operations, changes in financial position and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

Toronto, Canada
March 4, 1987

December 31, 1986 ($ 000's except for per share amounts)

1. Summary of significant accounting policies:

(a) Basis of presentation:

The Corporation is incorporated under the Business Corporations Act of the Province of Ontario and is engaged through its subsidiaries in the management of and the investment in hotel properties in Canada, the United States and London, England. At December 31, 1986 the Corporation managed 20 hotels and had an equity interest in 13 hotels. The Corporation earns management and other related fees under long term management contracts based generally on a percentage of total revenues of all managed hotels.

The Corporation's accounting policies and its standards of financial disclosure comply with accounting principles that are generally accepted in Canada. The significant accounting policies are summarized below.

(b) Principles of consolidation:

The consolidated financial statements include the accounts of the Corporation and its subsidiaries together with the Corporation's share of the assets, liabilities, revenues and expenses of hotel joint ventures in which it participates (note 5(b)). The Corporation consolidates five leased or wholly-owned hotel investments and proportionately consolidates three joint venture investments.

Investments in five other hotel partnerships are accounted for by the cost method because the percentage ownership does not give the Corporation significant influence.

In the event of a decline in the value of an investment which is other than temporary, the investment is written down to estimated realizable value.

(c) Translation of foreign currencies:

Foreign currency balances and transactions are translated into Canadian dollars at the rates of exchange on the balance sheet date for monetary items, on the date of transaction for non-monetary items and at the rates in effect during the year for revenues and expenses. The resulting gains or losses are included in the determination of net income, except for gains or losses related to long-term monetary items which are deferred and amortized on a straight-line basis over their ascertainable life.

The financial statements of foreign investments, which are designated as self-sustaining operations, are translated as follows:

(i) Assets and liabilities at rates of exchange on the balance sheet date.

(ii) Revenue and expense items at rates of exchange in effect during the year.

(iii) The resulting exchange gains and losses are deferred and included as a separate component of shareholders' equity.

(d) Fixed assets:

Land, buildings, furniture, fixtures, equipment and leasehold interests and improvements are recorded at cost less accumulated depreciation and amortization.

Operating equipment which includes linen and tableware is valued as follows:

Tableware and non-circulating linen – at the lower of average cost and replacement cost
Circulating linen – at 50% of average cost

(e) Depreciation and amortization of fixed assets:

Depreciation on buildings is recorded on a sinking fund basis over the lesser of the estimated useful life of the building or 40 years. The sinking fund method provides a depreciation charge in amounts which increase annually, consisting of a fixed annual sum together with interest thereon compounded at 5% per annum.

Depreciation on furniture, fixtures and equipment is recorded at rates which will fully depreciate the assets over their estimated useful lives. The estimated composite useful life for furniture, fixtures and equipment ranges from 5 to 10 years on a straight-line basis.

Amortization of leasehold interests and improvements is recorded on a straight-line basis over the term of the lease to a maximum of 25 years.

(f) Inventory:

Inventory of food, beverages and supplies is valued at the lower of cost as determined on a first in, first out basis and replacement cost.

(g) Intercompany management fees:

Included in the statement of operations are intercompany revenues and expenses relating to management fees charged by the Hotel Management Operations to the Hotel Ownership Operations. These charges have been disclosed in the statement of operations.

2. Receivables:

	1986	1985
Trade accounts	$ 11,043	11,621
Receivable from hotel partnerships, affiliates and managed hotels	6,080	5,364
Other	1,668	694
	$ 18,791	17,679

3. Prepaid rent:

The Corporation has made advance rental payments to the owner of one of its leased hotels. This amount is being charged to operations over the lease term to January 30, 2000 on a straight-line basis.

4. Notes and mortgages receivable:

Included in the mortgages receivable of $12,073 (1985 – $8,944) is an amount of $2,641 (1985 – $2,386) due from directors, officers and employees of Four Seasons Hotels Limited representing interest-free house mortgage loans. The remaining mortgages bear interest at rates varying from 10% to bank prime plus 2%.

Mortgages in the amount of $4,426 mature in 1990. The majority of the remaining mortgages receivable mature after 1991.

5. Hotel investments:

(a) Hotel partnerships and managed hotels:

The Corporation's investment in hotel partnerships and managed hotels of $10,014 (1985 – $10,021) represents capital investments, advances and unamortized development costs for hotels which are carried on a cost basis.

(b) Hotel joint ventures:

Included in the consolidated financial statements are the Corporation's proportionate share of hotel joint venture assets (1986 – $13,306, 1985 – $14,147), liabilities (1986 – $10,660, 1985 – $10,703), revenues (1986 – $19,017, 1985 – $18,296) and net loss before taxes (1986 – $491, 1985 – $386).

(c) The Corporation is contingently liable for all the obligations of certain of the partnerships and joint ventures in which it has a direct interest. However, against this contingent liability the Corporation would have a claim upon the assets of the partnerships and joint ventures and their partners.

6. Fixed assets:

	1986	1985
Land	$ 2,034	2,034
Buildings	11,734	10,126
Furniture, fixtures and equipment	48,765	46,464
Leasehold interests and improvements	39,169	36,569
	101,702	95,193
Accumulated depreciation and amortization	(32,745)	(28,510)
	68,957	66,683
Operating equipment	5,176	5,452
	$ 74,133	72,135

7. Long-term debt:

	1986	1985
Term loans:		
Payable in Pounds Sterling 15,000 (1985 – 15,000) interest at 12%, secured by a hotel lease and the shares of a subsidiary company, due 1991	$ 30,600	30,270
Payable in United States funds – $5,335	—	7,456
Payable in Pounds Sterling – 5,523	—	11,146
Mortgages:		
Secured by fixed charges on specific properties, due on varying dates to 1993, interest varying from bank prime plus ½% to 15%	8,333	5,333
Notes payable:		
Payable in Canadian funds, due on various dates to 1993, interest at rates varying from 6% to 10% with weighted average rate of 7% (1985 – 8.4%)	881	1,538
Debentures, interest at bank prime rate plus 1½%	—	9,023
Series A Sinking Fund Debentures, 8%	—	1,750
Deferred foreign exchange credits	—	1,118
Other long-term liabilities	2,782	2,538
	42,596	70,172
Due within one year	1,417	18,942
	$ 41,179	51,230

The annual principal repayments of long-term debt are as follows:

1987	$ 1,417
1988	1,227
1989	5,360
1990	336
1991	31,027
Subsequent to 1991	3,229
	$ 42,596

8. Interest:

Interest expense, net is comprised as follows:

	1986	1985
Interest on long-term debt	$ 6,324	11,201
Other interest expense	295	303
Dividends on preferred shares of a subsidiary	260	300
Interest income	(2,033)	(5,203)
Interest capitalized	—	(201)
Interest expense, net	$ 4,846	6,400

9. Shareholders' equity:

(a) Capital Stock:

Authorized at December 31, 1986 and December 31, 1985:

2,781,283 Multiple Voting Shares ("MVS"), voting (twelve votes per share) and ranking equally with Subordinate Voting Shares ("SVS") as to dividends and distributions on liquidation or wind-up of the Corporation. The shares are convertible into SVS on a one for one basis at the option of the holder. The shares automatically convert into SVS upon any transfer of shares outside of the family of Isadore Sharp, except a transfer of a majority of the shares to a purchaser who also makes an equivalent offer to purchase all outstanding MVS and SVS.

Unlimited Subordinate Voting Shares, voting (one vote per share) and ranking equally with MVS as to dividends and distributions on liquidation or wind-up of the Corporation.

290,000 Employee Preference Shares ("EPS"), non-voting and ranking equally (to the extent of issue price plus declared and unpaid dividends) with MVS and SVS as to distributions on liquidation or wind-up of the Corporation. Dividends will be as determined by the board of directors. The shares are convertible at the option of the holder (20% exercisable on the anniversaries of the first through fifth years from the date of issue) into 1.07143 SVS per EPS. The shares must be redeemed by the Corporation within 35 days after the holder ceases to be an employee of the Corporation, or after ten years from issuance.

Unlimited First Preference Shares, non-voting and ranking prior to all other shares with respect to payment of dividends and distributions on liquidation or wind-up of the Corporation. The dividend rate, redemption and conversion rights are to be determined prior to issuance by the directors of the Corporation.

Authorized at December 31, 1985 (and cancelled during 1986):

Unlimited Class A shares, voting and participating equally with all other shares as to dividends per share.

1,229,469 Class B shares, redeemable voting and participating equally with all other shares as to dividends per share to a maximum of 38 cents per share per annum.

8,700 Class C shares, voting and participating equally with all other shares as to dividends per share. The shares are convertible into Class A shares at any time at the option of the holder on a share for share basis.

Unlimited Class D shares, redeemable non-voting and participating equally with all other shares as to dividends per share.

Unlimited Class F shares, redeemable non-voting and participating equally with all other shares as to dividends per share.

Issued and fully paid:

	1986		1985	
	Shares	**Stated Value**	Shares	Stated Value
Multiple Voting Shares	**2,781,283**	**$ 61**	—	$ —
Subordinate Voting Shares	**7,057,983**	**34,635**	—	—
Employee Preference Shares	**285,000**	**4,275**	290,000	4,350
Class A Shares	—	—	100,000	—
Class B Shares	—	—	1,229,469	1,677
Class C Shares	—	—	8,700	—
Class D Shares	—	—	100,000	—
Class F Shares	—	—	8,700	2,001
		$ 38,971		$ 8,028

On December 23, 1985, a former director and senior officer exercised his option to acquire 3,535 units, each consisting of one Class C share and one Class F share at a price of $459 per unit for an aggregate consideration of $1,623.

In December 1985, the Corporation issued 290,000 EPS for total proceeds of $4,350. In February 1986, 5,000 EPS were redeemed by the Corporation for cash.

In December 1985, four senior officers of the Corporation were granted options to purchase SVS. There are 800,000 SVS under option. 500,000 shares are purchasable at $12.60 per share, and are currently exercisable. 300,000 shares are purchasable at $6.33 per share of which 150,000 were purchased in February 1986 by three senior officers for aggregate consideration of $949. The expiry date of the options is December 1995. Of the remaining 150,000 shares under option not currently exercisable, 20% will become exercisable on each of the third, fourth, fifth, sixth and seventh anniversaries from the date of grant. All such options become immediately exercisable in the event of the retirement, incapacity or death of the senior officer or a change in control of the Corporation.

As of December 31, 1986, 323,927 SVS (1985 – 168,927) were reserved for issuance under an executive share option plan. The eligible executives and employees will be granted options to acquire SVS at a price which is not less than 90% of the fair market value at the date of grant. The options will not be transferable and will be for a term of 10 years, 20% exercisable on each anniversary of the first through fifth years from the date of grant. In September, 1986 two such options were granted for an aggregate of 10,000 SVS at a price of $16.76 per share.

In February 1986, all of the issued and outstanding shares as at December 31, 1985 (except for the EPS) were reclassified into MVS on the basis of 45.36870 MVS for each Class A or Class C Share, 43.77571 MVS for each Class D or Class F Share and 0.3393 MVS for each Class B Share. Subsequent to this reclassification, and as part of the transfer of discontinued net assets to a company which was owned by the shareholders of the Corporation at the date of the transfer, 2,785,727 MVS held by this company were purchased by the Corporation for cancellation (Note 12). The remaining MVS held by all holders except Isadore Sharp and his immediate family were then converted into SVS on a one for one basis. Also in February 1986, the Corporation completed a public share offering of 2,367,857 SVS for $33,150 net of expenses of $2,067.

(b) Minimum shareholders' equity:

Under the terms of a hotel lease the Corporation's principal subsidiary has undertaken that it will not permit total shareholders' equity to be less than $25,000.

(c) Equity adjustment from foreign currency translation:

The components of the equity adjustment from foreign currency translation are as follows:

	1986	1985
Working capital	**$ 303**	323
Fixed assets, net	**2,231**	2,925
Other assets	**124**	154
Long-term debt	**(5,330)**	(4,832)
Deferred taxes	**135**	151
Total equity adjustment from foreign currency translation	**$ (2,537)**	(1,279)

10. Income taxes:

The effective rate of income taxes provided in the consolidated statement of operations varies from the rates specified in the taxing statutes as follows:

	1986	1985
	%	%
Combined basic federal and provincial income tax rate	50.8	49.8
Lower foreign income tax rates	(3.7)	(3.7)
Preferred dividends of a subsidiary in net interest	0.7	2.1
Other	(0.3)	3.2
	47.5	51.4

11. Leases:

The Corporation has entered into lease agreements for certain hotel properties for periods up to the year 2054. The lease terms may be extended under renewal options.

Future minimum lease payments, exclusive of any contingent rentals and occupancy costs, are as follows:

1987	$ 15,299
1988	17,436
1989	16,492
1990	14,116
1991	14,696
Subsequent to 1991	504,343

12. Discontinued operations:

The Corporation identified certain assets and related liabilities which were ancillary to the Corporation's principal business of managing and owning hotels. The Corporation transferred these discontinued net assets in February 1986 to a company which was owned by the shareholders of the Corporation at that date as consideration for the purchase for cancellation of the Corporation's MVS held by this company. The excess of the book value of the assets transferred, less debts assumed, over the stated capital of the MVS purchased and cancelled, which was $36,220, was applied to reduce the Corporation's retained earnings.

The discontinued net assets which were included in the balance sheet were as follows:

	At the date of transfer	As at December 31, 1985
Current assets	$ 2,326	2,580
Mortgages and long-term receivables	44,362	43,032
Real estate investments	8,575	8,138
Oil and gas and other investments	5,122	5,361
Discontinued assets	$ 60,385	59,111
Current liabilities	$ 119	83
Long-term debt	23,033	21,666
Liabilities related to discontinued assets	$ 23,152	21,749
Net assets transferred	$ 37,233	
Applied as follows:		
Stated capital of MVS cancelled	$ 1,013	
Retained earnings	36,220	
	$ 37,233	

The earnings (loss) before interest and taxes from discontinued operations include the revenues and expenses attributable to these net assets and the operating results of hotels which were sold during 1985 (note 14). The earnings (loss) before interest and taxes from discontinued operations were as follows:

Year ended December 31, 1986	1986	1985
Revenues	$ 48	6,421
Expenses		
Cost of sales and expenses	14	6,318
Working capital provided by discontinued operations	34	103
Depreciation and amortization	(13)	162
Share of loss of real estate partnerships and joint ventures	—	281
Earnings (loss) before interest and taxes from discontinued operations	$ 47	(340)

The Corporation is contingently liable for certain obligations in connection with the discontinued net assets:

(a) mortgages in the aggregate amount of $21,069 as at December 31, 1986;

(b) nine per cent of mortgage payments and other cash flow deficiencies incurred in respect of the Four Seasons Hotel, in Houston;

(c) guarantees and undertakings given by the Corporation related to certain of the discontinued assets aggregating $1,573 as at December 31, 1986;

(d) any other contingent liabilities related to the discontinued assets.

The related company has indemnified the Corporation for any payments made by the Corporation in respect of these contingent liabilities.

13. Contingencies:

(a) The Corporation has agreed to indemnify the landlord of one of its leased hotels for liabilities which may result from termination of a lease between the landlord and the previous tenant. Legal and counter legal actions have been instituted between the previous tenant and the landlord for cost and damages associated with the termination of the former lease agreement. However, the extent of the liability is not determinable at this time; the amount of any settlement once determined, will be added to the cost of acquiring the leasehold interest and amortized over the term of the lease. This undertaking has been secured by an irrevocable letter of credit and a guarantee issued by its banker in the amount of $8,300 ($6,000 U.S.) at December 31, 1986.

(b) In the ordinary course of its business, the Corporation is named as defendant in legal proceedings resulting from incidents taking place at its hotels. The Corporation maintains comprehensive liability insurance and also requires hotel owners to maintain adequate insurance coverage. The Corporation believes such coverage to be of a nature and amount sufficient to ensure that it is fully protected from suffering any financial loss as a result of such claims.

14. Extraordinary items:

Extraordinary items are as follows:

	1986	1985
Gain on sale of hotel investments, net of income taxes of $657	$ —	1,671
Disposal of hotel investment, net of income taxes recoverable of $131	—	(463)
	$ —	1,208

15. Earnings per share:

Fully diluted earnings per share for the year ended December 31, 1986 were $0.94.

16. Segmented information:

	1986	1985
Revenues:		
United States	$ 64,979	54,825
Canada	97,857	83,763
United Kingdom	37,851	31,249
Eliminations	(6,030)	(4,934)
Consolidated revenues	$194,657	164,903
Operating profit:		
United States	$ 2,989	2,009
Canada	11,710	5,106
United Kingdom	8,227	6,719
Total operating profit	$ 22,926	13,834
Identifiable assets:		
United States	$ 32,869	31,831
Canada	40,939	40,641
United Kingdom	13,707	12,583
Eliminations	—	(796)
	87,515	84,259
Corporate assets	44,826	28,329
Investments	10,014	10,021
Discontinued assets	—	59,111
	$142,355	181,720

17. Subsequent event:

On February 27, 1987 the Corporation signed an agreement to purchase a 50% interest in the 228-room Santa Barbara Biltmore resort hotel in California. The Corporation entered into an agreement to manage the hotel and will own 50% of the freehold interest in the land, buildings, furniture and fixtures. This acquisition will be financed by a non-recourse first mortgage on the property with a net equity commitment on the purchase estimated at $6,500 U.S. The Corporation has also agreed to provide a letter of credit of $6,500 U.S. for its share of a proposed renovation program for the hotel. The transaction is expected to close by March 31, 1987.

DESCRIPTION OF HOTELS

Hotel and Location	Date of Opening[1]/ Acquisition by FSH[2]/ Major renovations[3]	Number of rooms	Management Agreement Initial expiry	Management Agreement Final expiry	Ownership Equity Interest	Ownership Title
FOUR SEASONS HOTEL Austin, Texas	1986[1]	300	2022	2047	—	—
FOUR SEASONS HOTEL Boston, Massachusetts	1985[1]	288	2010	2085	15%	Freehold
RITZ-CARLTON HOTEL Chicago, Illinois	1975[1]/1977[2]	431	2025	2025	25%	Leasehold
FOUR SEASONS HOTEL and RESORT Dallas, Texas	1986[1]	315	2002	2042	—	—
FOUR SEASONS HOTEL Edmonton, Alberta	1978[1]	314	2003	2028	50%	Leasehold
FOUR SEASONS HOTEL Houston, Texas	1982[2]	399	2016	2046	1%	Freehold
INN ON THE PARK Houston, Texas	1981[1]	383	2015	2075	—	—
INN ON THE PARK London, England	1970[1]	227	2054	2054	100%	Leasehold
LE QUATRE SAISONS Montreal, Quebec	1976[1]/1983[2]	300	2003	2043	—	—
THE PIERRE New York, New York	1929[1]/1981[2]	196	2001	2001	100%	Leasehold
FOUR SEASONS HOTEL Newport Beach, California	1986[1]	303	2016	2046	—	—
FOUR SEASONS HOTEL Ottawa, Ontario	1972[1]/1977[2]	236	2002	2017	67%	Freehold
FOUR SEASONS HOTEL Philadelphia, Pennsylvania	1983[1]	371	2013	2053	5%	Freehold
FOUR SEASONS HOTEL San Antonio, Texas	1979[1]	252	1998	2053	—	—
FOUR SEASONS CLIFT HOTEL San Francisco, California	1915[1]/1976[2]/ 1983[3]	329	2006	2066	—	—
FOUR SEASONS BILTMORE Santa Barbara, California	1929[1]/1987[2]	228	2012	2072	50%	Freehold
FOUR SEASONS OLYMPIC HOTEL Seattle, Washington	1924[1]/1982[2]	450	2040	2040	3%	Leasehold
FOUR SEASONS HOTEL Toronto, Ontario	1974[1]/1978[2]/ 1984[3]	379	2003	2077	100%	Leasehold
INN ON THE PARK Toronto, Ontario	1963 + 1971[1]/ 1985[3]	568	1994	2014	—	—
FOUR SEASONS HOTEL Vancouver, B.C.	1976[1]	385	2000	2035	100%	Leasehold
FOUR SEASONS HOTEL Washington, D.C.	1979[1]	197	2007	2022	15%	Freehold
MINAKI LODGE Minaki, Ontario	1925[1]/1986[2]	144	1997*	1997*	100%	Freehold
Under Development:						
FOUR SEASONS HOTEL Chicago, Illinois	1989[1]	342	2024	2104	8%	Leasehold
FOUR SEASONS HOTEL Los Angeles, California	1987[1]	287	2041	2061	—	—
FOUR SEASONS WAILEA Maui, Hawaii	1990[1]	343	2010	2055	—	—

Note: Information concerning hotels under development is based upon agreements and letters of intent and may be subject to change. The dates of opening have been estimated. Expiry dates are calculated from the estimated date of opening.

*Managed by Elgin House Resort Limited

FOUR SEASONS HOTELS INC.

FOUR SEASONS HOTELS LIMITED

Directors and Officers

*Edmond M. Creed
Director
Chairman
Creeds Limited

Frederick Eisen
Director
Executive
Max Sharp & Son Construction Limited

*†H. Roger Garland
Director, Executive Vice-President and Secretary-Treasurer

*†Murray B. Koffler
Director
Partner
The Koffler Group

Douglas L. Ludwig
Assistant Treasurer

David C. Mongeau
Assistant Secretary and Corporate Counsel

*Isadore Sharp
Director, Chairman and President

Max Sharp
Director
Retired Executive

*John L. Sharpe
Director and Executive Vice-President

†Benjamin Swirsky
Director
Vice-Chairman and Chief Executive Officer
Bramalea Limited

Christopher Wallis
Director and Senior Vice-President

**Member of Executive Committee*

†Member of Audit Committee

Des informations en français peuvent être obtenues en écrivant au secrétaire.

Management Committee

Robert W. Bloch
Senior Vice-President Marketing

James F. Brown
Senior Vice-President Operations

H. Roger Garland
Executive Vice-President Development, Finance and Administration

Isadore Sharp
Chairman and President

John L. Sharpe
Executive Vice-President Operations

Christopher Wallis
Senior Vice-President Design and Construction

John W. Young
Senior Vice-President Human Resources

Head Office Vice-Presidents

J. Peter Buyze
Vice-President
Engineering, Design and Construction

James Cardy
Vice-President
Purchasing

Robert Cornell
Vice-President
Field Marketing

G. Douglas Hall
Vice-President
Corporate Communications

John M. Johnston
Vice-President
Development

Alfons E. Konrad
Vice-President
Food and Beverage

Douglas L. Ludwig
Vice-President
Corporate Controller

Jesse Maher
Vice-President
Operational Controller

William R. Misunas
Vice-President
National Sales

Regional Vice-Presidents

Stanley Bromley
Los Angeles
Newport Beach
San Francisco
Seattle

Antoine Corinthios
Chicago
Montreal
New York

Wolf H. Hengst
Austin
Dallas
Houston
San Antonio

Peter G. Martin
Boston
Philadelphia
Washington

Eugene Wagner
Ottawa
Toronto

CORPORATE INFORMATION

Transfer Agent and Registrar

The Canada Trust Company
Halifax Montreal Toronto Winnipeg Regina Calgary Vancouver

Auditors

Peat, Marwick, Mitchell & Co.

Stock Listings

The Toronto Stock Exchange
The Montreal Exchange

Annual Meeting

The Annual Meeting of Shareholders will be held at 3:00 p.m. on Thursday, May 21, 1987, in the Regency Ballroom, Four Seasons Hotel, Avenue Road, Toronto, Canada.

Designed by Bryan Mills & Associates Limited
Printed in Canada by Arthurs-Jones Lithographing Limited