Four Seasons Hotels

1985 Annual Report

"Concentration, the focused energy drawn
from a state of commitment, is the secret of strength. . ."

Ralph Waldo Emerson

Company Profile

Four Seasons Hotels sets the standard for quality hotel accommodation in North America.

The Canadian-based company manages 18 medium-sized luxury hotels in major cities throughout Canada, the United States and the United Kingdom.

Primarily a management company, with equity in 13 properties, Four Seasons enjoys association with a number of North America's leading developers and financial institutions — companies building hotels as part of prestigious multi-use complexes.

Five new hotels are currently under construction; this will add 1,600 guest rooms to the present 6,100. Approximately 7,000 people are employed in the hotels, the five national sales offices and the corporate head office in Toronto, Canada. Gross revenues under management for the year ending December 31, 1985 exceeded $440 million.

The company plans to expand its service to business and leisure travellers in the luxury hotel market, both in North America and internationally.

The Annual Meeting of Shareholders will be held at 3:30 p.m. on Thursday, June 12, 1986, in the Regency Ballroom Four Seasons Hotel, Avenue Road, Toronto, Canada.

On peut se procurer la version française du présent rapport en écrivant au Secrétaire.

Contents


DONNA WEBB

Highlights

- *1986 marks the Twenty-fifth Anniversary of Four Seasons Hotels.*
- *In 1985 the company initiated a public share offering completed early in 1986. The offering of 2,367,857 Subordinate Voting Shares at $14 per share provided total proceeds of $33,150,000.*
- *The company's earnings for 1985, before extraordinary items, were $3,449,000, up from $437,000 in 1984.*
- *Total revenues under management for 1985 were $440,514,000.*
- *The Four Seasons Hotel Boston, a 288-room hotel in downtown Boston, overlooking the Public Garden, opened in June, 1985.*
- *Construction is underway on five new hotels: the Las Colinas Inn and Conference Center, and the adjacent Four Seasons Fitness Resort and Spa in Dallas, to open April and May, 1986 respectively; the Four Seasons Newport Beach, California to open May, 1986; the Four Seasons Los Angeles and the Four Seasons Austin, Texas to open in early 1987; and the Four Seasons Chicago to open in 1989.*
- *The company moved to new corporate offices at 1165 Leslie Street in Toronto on December 20, 1985.*

Financial Highlights

(Thousands of dollars)	Actual 1984	Prospectus Forecast 1985	Actual 1985	Prospectus Forecast 1986
Total revenues of all managed hotels	$405,141	$436,729	$440,514	$517,386
Earnings before extraordinary items	$ 437	$ 3,050	$ 3,449	$ 8,813
Funds generated from continuing operations	$ 12,097	$ 12,805	$ 14,345	$ 23,232

"There are only two ways to create and sustain superior performance . . .
First, take exceptional care of your customers via superior service and superior quality.
Second, constantly innovate."

A PASSION FOR EXCELLENCE by Tom Peters and Nancy Austin

Chairman's Letter

In extending a warm welcome to our new shareholders, I feel I should mention that a milestone year lies ahead of us. Our issue of shares to the public was completed in February 1986, the same year in which we celebrate our twenty-fifth anniversary in the hotel industry. As we look back on our development and plan our next quarter-century of growth, the Board of Directors and I thank you for choosing to be part of what we are confident will be a long and successful association.

The theme chosen for this 1985 annual report is from our new advertising campaign: "Redefining the Grand Hotel: Innovation and Service". You may recall that the best-selling In Search of Excellence *began by singling out the Washington Four Seasons as an example of corporate excellence. In his new book,* A Passion for Excellence, *co-author Tom Peters identifies innovation and service as the main ingredients of success.*

I focus first on innovation because that is the way it all began. In 1960, faced with prohibitive real estate costs, we designed our first hotel around an inner court to create an oasis in an older part of Toronto. Our second hotel, in the suburbs, launched the now-familiar concept of a resort situated in a major urban centre. And by wedding the ease and comfort of the American hotel with the European tradition of detail and service, we created a new Canadian hybrid.

Europe was our next market. Here too, we defied the traditionalists who could not believe that London was ripe for a luxury hotel with New World ambiance. But the Inn on the Park London opened in 1970 to immediate acclaim, and as one of the world's most successful hotels, it made Four Seasons a world-class hotel company. Subsequent growth in the United States and Canada was steady: fifteen hotels in fifteen years.

Innovation was not confined to the physical property. Many of the services and amenities we introduced are now the norm for first-class luxury accommodation.
In response to a renewed interest in healthy living, new hotels and many of the older properties offer extensive fitness facilities. In 1984 we introduced an alternative gourmet cuisine, low in calories, cholesterol and sodium. The trend to lower alcohol consumption was anticipated in our lobby bars with their formal tea service. I believe this constant improvement through new ideas will continue, and that innovation will be rewarded with continuing industry leadership.

But more than any other single element, it is the quality of our service, the special attitude of our employees, which distinguishes the company. Over 25 years Four Seasons has developed a nucleus of knowledgeable, experienced people dedicated to customer satisfaction. In hiring new employees, experience is obviously relevant, but of equal importance is personality and attitude: the pride and enthusiasm which has become our company trademark.

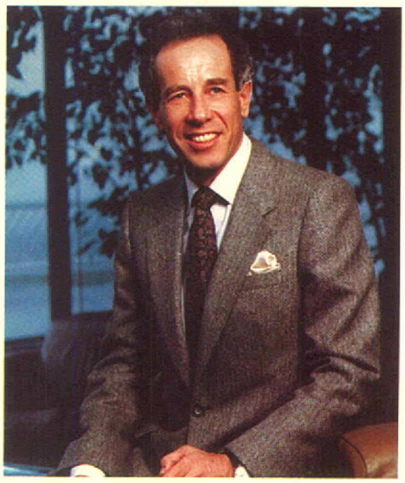
Our employees are largely responsible for the reputation we enjoy today, and to all of them,

we are grateful. It is these people, approximately 8,000 by year end 1986, who hold the key to our future growth. Every day they demonstrate, in their treatment of both guests and fellow employees, their respect for basic human values and their pride in personal achievement.

We bring this quality service and innovation together in a clear objective: to create the new grand hotel. Our strategy is to concentrate on a single industry segment — the upper end of the market — and to confine ourselves to medium-sized hotels of exceptional quality, the finest in each city in which we locate.

This strategy kept us relatively strong in the difficult period between 1982 and 1984. While competitors retrenched, at Four Seasons Hotels more than $65 million was invested in capital programs, and professional expertise in the marketing and the human resources areas was greatly upgraded. As a result, we came through the recession with our product intact, well positioned for the recovery.

In 1985, occupancies remained stable while rates in most markets moved up strongly, as reflected in our operating and financial statements. Texas and Western Canada remain weak, but key markets like Washington, London, Chicago and Toronto are expected to continue firm throughout 1986.



As the year progresses, more recently established hotels like the Four Seasons Hotels in Boston and Philadelphia should solidify leadership positions in their markets. This Spring, we open a hotel, conference centre, fitness resort and spa complex at Las Colinas, near Dallas, and in May, the Newport Beach Four Seasons expands our base on the West Coast. We will then have 20 Four Seasons hotels in operation, 13 in key locations across the United States.

With the product in place and an ample resource of dedicated people, our goal in 1986 is to broaden our market: to reinforce positive guest experience with new advertising initiatives. At every level, the message is clear: through innovation and service we have redefined the grand hotel, and these ingredients of success promise the same steady growth in the future that has characterized Four Seasons in the past.

Isadore Sharp, Chairman,
President and Chief Executive Officer


CHRIS



"Every strong culture derives from management's sensitivity . . .
Sensitive executives motivate people in the most effective, lasting ways"

CREATING EXCELLENCE Craig Hickman and Michael Silva

Hotel Operations

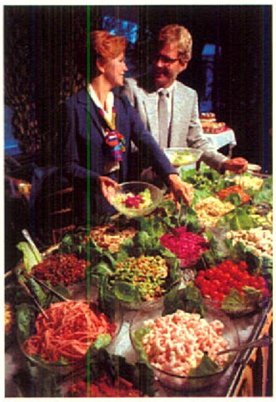
In July, 1985, Edward de Bono, author of Lateral Thinking, *was quoted in* Business Traveller: *"After efficiency, I think the attitude of friendliness and helpfulness is most important . . . The best standard of any hotel chain is unquestionably Canada's Four Seasons." Last year, the prestigious international poll conducted by* Institutional Investor *listed six Four Seasons hotels, more than any other hotel company, among the world's top fifty. The Four Seasons Washington was rated number one in North America, the Four Seasons Toronto, number one in Canada.*

Four Seasons has made its name preeminent in the American luxury market with a consistency that is the envy of the industry. This reputation is built primarily on service, on employee motivation and attitude. Ensuring that attitude and behaviour reflect the company standards is the principal challenge of management.

Success in meeting this challenge can be gauged by the company's employee turnover rate which is less than half the industry average. Another measure is a recent employee attitude survey. Researchers compared Four Seasons with other leading hotel chains and nationally known companies. The highest prior result on how well employees identify with their company was 3.2 on a 4-point scale. The result of the Four Seasons survey was a new high of 3.6.

Employee attitudes, essential to superior customer service, develop in an environment where the individual is involved and respected. And since motivation is instilled, above all, by example, Four Seasons' managers inspire emulation not by what they say but by what they do: by meticulous attention to detail, customer comment and employee suggestions. This is reinforced by evidence that company executives are 100% committed to quality. As Daniel Yankelovich, the American public opinion researcher, has noted, those companies that emphasize quality have the highest motivational levels.

The initial capital investment in Four Seasons guest rooms is at least 25% higher than the industry average. The company has a continuous renewal and renovation program; recently initiated upgrading programs costing more



than $20 million were completed in 1985. At Four Seasons Toronto, the overall room count was reduced from 515 to 375, in order to create the popular Four Seasons Room, which combines a regular bedroom and adjacent sitting room to give the business traveller the advantages of a traditional suite at a more economical cost. At the Four Seasons Vancouver, the Inn on the Park Toronto, and Le Quatre Saisons Montreal, new restaurant concepts offer patrons a choice of formal or casual dining.

The new Four Seasons Hotel in Boston, which opened in June 1985, represents the culmination of 25 years of innovative design. It blends Four Seasons' signatures like the lobby-bar with discreetly elegant guest rooms in an evocative residential atmosphere. This project, overlooking the Public Garden, also includes Four Seasons Place, one hundred residential condominium units above the hotel, all with complete access to the hotel services.

It is a fundamental principle at Four Seasons that successful marketing begins with the product, and our research has revealed a perceived product difference between Four Seasons and its closest competitors. The objective for the new corporate advertising campaign, launched in January 1986, is to build on this perception to increase our competitive lead.

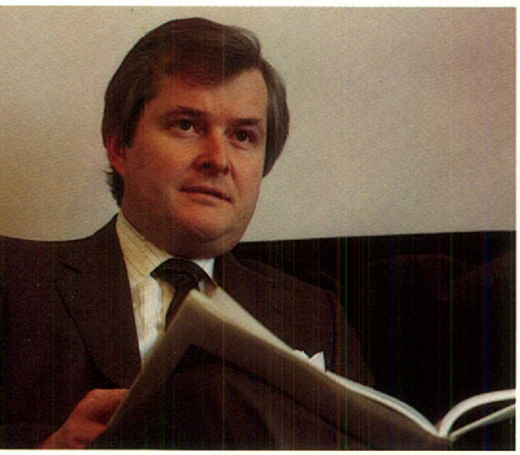
Corporate marketing strength was solidified in 1985 by an expanded and upgraded marketing division at Head Office. A fifth national sales office in Chicago was added to those in Toronto, New York, Washington, D.C., and Los Angeles. Two major market-oriented systems were initiated: computerization of the Central Reservations System which will be

introduced in 1986, and centralization of the locally-based Guest History System. The programs will allow staff to offer faster, more efficient reservation service, and to better identify the needs and expectations of returning guests. An added benefit will be a significantly expanded, more accessible market data base.

Operating profit margins in the major divisions — rooms and food and beverage — were higher than in 1984 reflecting our continuing emphasis on improved operating efficiencies. Despite industry-wide increases in taxes and insurance, major overhead expense ratios were maintained or reduced this past year. By late 1986 the expansion of marketing programs, particularly in direct sales activity and advertising, is expected to strengthen the profit picture.

Success is measured in many ways. 1985 was another gratifying year for individual hotel awards. Le Quatre Saisons Montreal joined the Ritz-Carlton in Chicago, The Pierre in New York, and Four Seasons Washington and Toronto in the Institutional Investor *poll of hotel ratings. The American Automobile Association's coveted Five-Diamond Award went to ten Four Seasons' properties, again more than any other hotel company. The Four Seasons Clift in San Francisco again received the select Mobil Five Star Award, and London's Inn on the Park was named by* Executive Travel *and* Ex-Po-Tel *as "Hotel of the Year" for the second consecutive year. London was also named "Hotel of the Year" in the 1986* Egon Ronay Guide.

But perhaps the company's most important award was the findings of the employee attitude survey. As one employee put it: "All of our management tries hard and cares about their work. Management at Four Seasons takes good care of their employees because they understand that this is what makes Four Seasons great."



John L. Sharpe
Executive Vice-President, Operations

Four Seasons Hotel, Austin, Texas

"Innovation is the specific instrument of entrepreneurs . . . an economic or social rather than a technical term."

INNOVATION AND ENTREPRENEURSHIP Peter F. Drucker

New Development

Four Seasons, an innovator in hotel design, has five new hotels under construction. One of them, the Las Colinas Inn and Conference Center in Dallas, is scheduled to open in April 1986. Adjacent to the Conference Center, the Four Seasons Fitness Resort and Spa, a separate establishment, will open in May, completing the hospitality industry's most all-inclusive facility: the first world-class hotel complex to combine a state-of-the-art conference centre with a full-scale spa and major sports club.

This is the company's first foray into the leisure market. It will offer a complete range of exercise and sports facilities, beauty aids and dining programs with professional supervision, personal counselling and medical evaluation, all in a luxurious and relaxing atmosphere. The company is confident that its experience in meeting the needs of the business travellers who make up some 90% of its clientele, and its reputation with these potential vacationers, are invaluable assets in this new growth initiative.

Preparations continue at the same time for the May 1986 opening of the 319-room Four Seasons Newport Beach in southern California, located within Newport Center opposite the exciting shops and boutiques of the Fashion Island shopping complex. This hotel, owned by the Irvine Company, will give Four Seasons a first strong base in the important southern California market.

Four Seasons prides itself on an ability to provide a consistent level of service with each new hotel opening. The company has a unique competitive edge in new development in that its low turnover rate enables an on-site management team to bring in 50 or 60 fully-trained employees who pass on experience and Four Seasons' standards to new staff members. In most cases the general manager is in place early in the construction phase, building his management team. In Newport Beach and Las Colinas the general managers were on site almost a full year before opening, working closely with their marketing personnel to develop a strong customer base for the new hotel.

Christopher Wallis
Senior Vice-President,
Design and Construction

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

Las Colinas Inn and Conference Center, Dallas, Texas

Four Seasons Hotel, Newport Beach, California

The full development of a North American hotel company also calls for a presence in Los Angeles, and construction is well underway on the Four Seasons Los Angeles which will open in early 1987. Its site on the boundary of Beverly Hills (Doheny Drive and Burton Way) offers access to one of the world's more affluent commercial and leisure centres. With landscaped gardens and terrace pool, the 349-room hotel promises an elegance and style reflective of the community it will serve.

The opening of the 308-room Four Seasons Austin is also slated for early 1987. Part of the Texas capital's San Jacinto Center Town Lake project, the hotel is the focal point for a seven-acre complex of office towers and shops with ready access to downtown Austin, the state capital buildings, the University of Texas and Mueller Municipal Airport.

The completion of a second Four Seasons hotel in Chicago is planned for early 1989. Located on the 900 block of North Michigan Avenue, this 342-room hotel will enhance a residential, office and retail complex under development by Urban Investment and Development Corporation and JMB Realty Corporation.

Four Seasons Hotel, Los Angeles, California

Each new hotel developed by Four Seasons incorporates the latest equipment and innovative design. For example, in the Four Seasons Philadelphia we added small boardrooms on guest floors, each complete with washroom, pantry and a breakout room so that calls can be made and taken without disturbing a meeting. Smaller groups of business travellers have found them so convenient that these rooms are being built into all of the new Four Seasons hotels.

The company estimates that cumulatively over the next five years, the five hotels now under development will add some $20 million (U.S.) to management fee income, with relatively little increase in corporate overhead. They will also heighten awareness of the Four Seasons' name among potential customers and partners.

The company is also considering sites for luxury resorts in areas like Southern California and Hawaii.

In addition, Four Seasons Hotels, in joint venture with Kuo Investments of Singapore, is continually reviewing offers to develop and manage hotels outside the United States and Canada. Business today is a global web of interpersonal relations and many Four Seasons' customers are part of this customer base of the luxury hotel market abroad. The company is evaluating locations in major business and tourist centres such as Paris and Zurich, Hong Kong and Tokyo.

Great care is taken to ensure that growth is compatible with the ability to deliver quality. But though high standards of service and quality are set, Four Seasons hotels are not standardized. Each has its own distinct, sometimes regional, personality, reflected in cuisine, decor and atmosphere. The grand hotel must embrace as well as embellish its community.

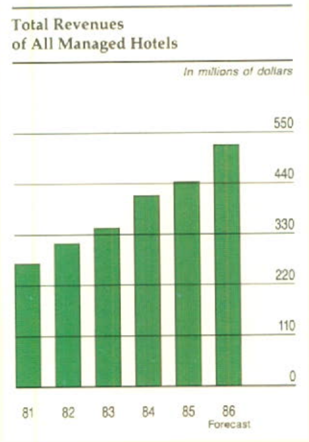
Financially, 1985 was a record year for Four Seasons. Revenues under management reached $441 million up from $405 million in 1984, earnings before extraordinary items exceeded $3.4 million, compared to $440,000 in the previous year, and funds generated from continuing operations exceeded $14 million.

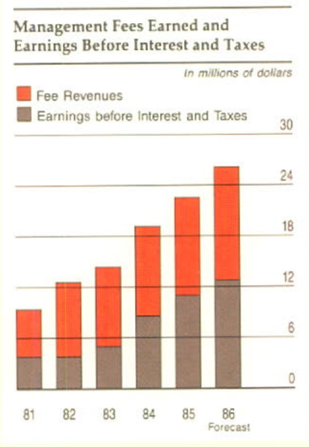
Subsequent to the year end a corporate restructuring and a public share issue were completed, resulting in a significantly strengthened debt to equity ratio reduced from 2:1 at December 31, 1985 to 1:1 on a proforma basis.

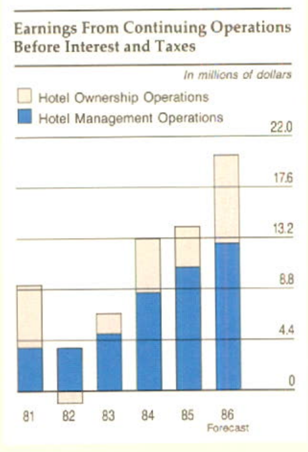
Restructuring disposed of assets and related liabilities (see note 12 to the financial statements) identified as extraneous to the Corporation's principal business, the management and ownership of hotels, thereby creating a more consistently defined business operation. Combined with the issue of 2,367,857 Subordinate Voting Shares at $14 per share, completed in February 1986, the Corporation was able to reduce its net debt position by $52 million. Long-term debt with variable interest rates now represents only 29% of the pro-forma debt position as at December 31, 1985. In considering future development opportunities, the company now enjoys substantially increased financial flexibility.

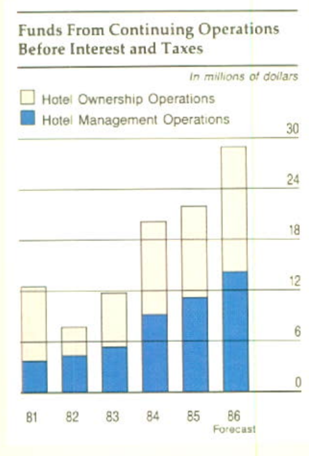
As an operating strategy, in recent years, Four Seasons has emphasized expansion of the hotel management segment of the business which contributed 77% of our total operating earnings in 1985. The financial characteristics of this business are based on long-term management contracts (average initial term 32 years), producing monthly fees which are largely calculated as a percentage of gross operating revenues from each hotel. This generates a relatively stable and predictable stream of earnings and cash flow involving little or no capital investment.

Hotel ownership also continues to be an important part of Four Seasons' long term financial strategy. To ensure the long term financial stability of a project, the Corporation seeks association with North America's major developers and financiers. Generally, equity participation is less than 25% and is structured in a way that limits financial exposure to a fixed dollar amount. At the same time these investments provide the potential for long term capital appreciation together with significant cash generation during the term of ownership. The Corporation holds ownership positions currently in 13 hotels located, for the most part, in stable, mature markets.









Hotel Management Operations
Fee revenues increased by 23% to $23.4 million in 1985. This increase can be attributed to development and purchasing fees earned on the hotels under development, fees which commenced with the opening of the Four Seasons Boston in June 1985, and, as well, the strengthening of both the U.S. dollar and the Pound Sterling against the Canadian dollar.

Total fee revenues as a percentage of total revenues of all managed hotels have increased from 4.7% in 1984 to 5.3% in 1985. This improvement relates to increased development and incentive fees which are not calculated as a percentage of revenue. The importance of the U.S. market to the Corporation's current earnings and future expansion is reflected in U.S. fee income representing 63% of total fee income in 1985.

Earnings before interest and taxes from management operations increased by 30% in 1985 to $10.6 million. The increased fee revenues were accompanied by an increase in the profit margin in 1985 from 43% to 46%. The Corporation anticipates that the profit margin will increase even further in the next few years as the corporate staff and cost structure is now in place to support the expansion in progress.

Earnings before interest and taxes are forecast to increase 21% to $12.9 million in 1986. This increase will result in part from the opening of hotels in Dallas and Newport Beach, as well as the continued purchasing and development fees of present projects.

Hotel Ownership Operations
This business segment reflects the earnings of the Corporation as a hotel owner where the Corporation has at least a 20% interest in a property. The Corporation accounts for hotels where it has less than a 20% interest on a cost basis. Earnings before interest and taxes decreased in 1985 to $3.2 million from $4.8 million in 1984. This was caused in part by reduced earnings at The Pierre due to a month-long hotel workers' strike in New York City and further softening of the Vancouver market. These reductions were partially offset by improved operating results in London and the stronger Pound Sterling exchange rate in 1985 compared to 1984.

Earnings before interest and taxes are forecast to increase to $7.3 million in 1986. The forecasted increase is primarily attributable to increased occupancies and room rates in Vancouver where Expo'86 is being held, generally higher achieved room rates, and stronger exchange rates in the United States and United Kingdom.

Net Earnings
Earnings before extraordinary items increased by $3.0 million during 1985 to $3.4 million. Net interest costs decreased by $1.6 million in 1985 due to interest income received on mortgages taken back in the Calgary (1985) and Inn on the Park, Toronto (1984) sales. The effective tax rate declined from 85.2% in 1984 to 51.4% in 1985. The 1984 tax rate was above normal statutory rates due substantially to income debenture interest which was not deductible for tax purposes. This income debenture was repaid on December 31, 1984.

The extraordinary gain of $1.2 million in 1985 was achieved from the sale of the Calgary hotel in May 1985 and the disposal of our equity interest in the Inn on the Park, Houston in October 1985.

Net earnings are forecast to increase to $8.8 million in 1986 ($0.94 per share), up from $4.7 million ($0.67 per share) in 1985. Net interest costs are expected to decrease from $6.4 million in 1985 to $3.3 million. This decrease is attributed to the reduction of debt due to the public share issue and corporate reorganization. Funds generated from operations are forecast to exceed $23 million in 1986 ($2.43 per share) up from $14.3 million ($1.67 per share) in 1985.

Five Year Financial Review

Years Ended December 31 ($000's)	1986 Forecast	1985	1985 Forecast	1984	1983	1982	1981
	(unaudited)		(unaudited)				
Total consolidated revenues	$184,640	164,903	161,466	154,048	111,864	104,018	95,372
Hotel Management Operations							
Total revenues of all managed hotels	$517,386	440,514	436,729	405,141	347,512	304,420	265,335
Fee revenues	$ 26,266	23,397	22,638	19,047	13,996	12,569	9,065
Expenses							
– General and administrative	12,654	12,157	12,016	10,060	8,568	8,408	5,201
– Depreciation and amortization	743	594	577	819	623	462	210
	13,397	12,751	12,593	10,879	9,191	8,870	5,411
Earnings before interest and taxes	12,869	10,646	10,045	8,168	4,805	3,699	3,654
Hotel Ownership Operations							
Revenues	166,459	148,809	145,930	142,730	103,764	97,307	91,459
Expenses							
– Cost of sales and expenses	143,879	130,772	128,679	124,646	92,743	89,563	79,359
– Fees to Hotel Management Operations	8,085	7,303	7,102	6,916	4,779	4,230	3,522
– Depreciation and amortization	7,180	7,546	6,542	6,324	4,942	4,556	3,235
	159,144	145,621	142,323	137,886	102,464	98,349	86,116
Earnings (loss) before interest and taxes	7,315	3,188	3,607	4,844	1,300	(1,042)	5,343
Earnings from continuing operations before interest and taxes	20,184	13,834	13,652	13,012	6,105	2,657	8,997
Loss (earnings) from discontinued operations before interest and taxes	—	340	686	2,092	3,153	(7,027)	(9,249)
Interest, net	3,345	6,400	6,822	7,966	8,383	14,436	13,783
Earnings (loss) before income taxes	16,839	7,094	6,144	2,954	(5,431)	(4,752)	4,463
Income taxes							
– Current	1,530	1,483	1,144	1,054	84	314	299
– Deferred (recoverable)	6,496	2,162	1,950	1,463	(1,995)	(3,026)	3,116
	8,026	3,645	3,094	2,517	(1,911)	(2,712)	3,415
Earnings (loss) before extraordinary items	8,813	3,449	3,050	437	(3,520)	(2,040)	1,048
Extraordinary items	—	1,208	1,278	4,730	9,166	—	(107)
Net earnings (loss)	$ 8,813	4,657	4,328	5,167	5,646	(2,040)	941
Funds from continuing operations before extraordinary items	$ 23,232	14,345	12,805	12,097	3,465	(6,813)	(1,378)

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 three months ended December 31, 1985 and the year ending December 31, 1986. At this time, there are no significant changes required to update the 1986 forecast included in the prospectus.

The assumptions used in the preparation of the financial forecast for the year ending December 31, 1986, although considered reasonable by the Corporation at the time of preparation, may prove to be incorrect. The actual results achieved during the forecast period will probably vary from the forecast results and the variations may be material.

Consolidated Statement of Operations

Year ended December 31, 1985 ($000's)	1985	1984
Total consolidated revenues (note 1(g))	$ 164,903	154,048
Hotel Management Operations		
Total revenues of all managed hotels (note 1(a))	$ 440,514	405,141
Fee revenues	$ 23,397	19,047
Expenses — General and administrative	12,157	10,060
Depreciation	337	350
Amortization	257	469
	12,751	10,879
Earnings before interest and taxes	10,646	8,168
Hotel Ownership Operations		
Revenues	148,809	142,730
Expenses — Cost of sales and expenses	130,772	124,646
Fees to Hotel Management Operations	7,303	6,916
Depreciation	4,160	3,578
Amortization	3,386	2,746
	145,621	137,886
Earnings before interest and taxes	3,188	4,844
Earnings from continuing operations before interest and taxes	13,834	13,012
Loss from discontinued operations before interest and taxes (note 12)	340	2,092
Interest, net (note 8)	6,400	7,966
Earnings before income taxes	7,094	2,954
Income taxes (note 10) — Current	1,483	1,054
— Deferred	2,162	1,463
	3,645	2,517
Earnings before extraordinary items	3,449	437
Extraordinary items (note 14)	1,208	4,730
Net earnings (note 1(h))	$ 4,657	5,167

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

As at December 31, 1985 ($000's)	Pro-forma 1985 (Note 1(h)) (unaudited)	**1985**	1984
ASSETS			
Current Assets:			
Cash and short-term investments	$ 14,248	**4,061**	4,407
Receivables (note 2)	17,679	**17,679**	15,232
Inventory	2,611	**2,611**	3,232
Prepaid expenses	1,551	**1,551**	1,306
Total current assets	36,089	**25,902**	24,177
Prepaid rent (note 3)	3,427	**3,427**	3,689
Mortgages receivable (notes 4 and 12)	8,944	**8,944**	45,887
Investments:			
Hotel partnerships and managed hotels (note 5)	9,787	**9,787**	7,421
Real estate partnerships and joint ventures (note 12)	—	**—**	9,363
Other (note 12)	234	**234**	6,348
	10,021	**10,021**	23,132
Fixed assets (note 6)	72,135	**72,135**	67,619
Other assets	2,180	**2,180**	1,690
Discontinued assets (note 12)	—	**59,111**	—
	$ 132,796	**181,720**	166,194

Consolidated Balance Sheet

As at December 31, 1985 ($000's)	Pro-forma 1985 (Note 1(h)) (unaudited)	**1985**	1984
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities:			
Bank indebtedness	$ —	—	387
Accounts payable and accrued liabilities	26,794	**26,794**	23,850
Long-term debt due within one year	9,669	**18,942**	18,819
Total current liabilities	36,463	**45,736**	43,056
Long-term debt (note 7)	40,465	**51,230**	66,158
Deferred income taxes	17,286	**17,286**	14,043
Preferred shares of a subsidiary	3,794	**3,794**	3,804
Liabilities related to discontinued assets (note 12)	—	**21,749**	—
Shareholders' equity: (note 9)			
Capital stock	37,239	**8,028**	2,266
Contributed surplus	4,685	**4,685**	4,685
Retained earnings	(5,857)	**30,491**	26,405
Equity adjustment from foreign currency translation	(1,279)	**(1,279)**	5,777
Total shareholders' equity	34,788	**41,925**	39,133
Contingencies and commitments (notes 12 and 13)			
	$ 132,796	**181,720**	166,194

Approved on behalf of the Board of Directors:

Director

Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Provided by Operations

Year ended December 31, 1985 ($000's)	1985	1984
Cash provided by (used in) operations		
Hotel Management Operations	**$ 11,240**	8,987
Hotel Ownership Operations	**10,988**	12,130
Discontinued Operations	**103**	266
Interest	**(6,400)**	(7,966)
Current taxes	**(1,483)**	(1,054)
Working capital from operations	**14,448**	12,363
Change in non-cash working capital applicable to operations excluding current portion of long-term debt	**(2,031)**	2,945
Cash provided by operations	**$ 12,417**	15,308
Hotel Management Operations		
Earnings before interest and taxes	**$ 10,646**	8,168
Add items not requiring an outlay of funds:		
Depreciation and amortization	**594**	819
Working capital provided by hotel management operations	**$ 11,240**	8,987
Hotel Ownership Operations		
Earnings before interest and taxes	**$ 3,188**	4,844
Add (deduct) items not requiring (providing) an outlay (inflow) of funds:		
Depreciation and amortization	**7,546**	6,324
Amortization of prepaid rent	**262**	262
Foreign exchange (gain) loss	**(248)**	700
Equity loss provision	**240**	—
Working capital provided by hotel ownership operations	**$ 10,988**	12,130
Discontinued Operations		
Loss before interest and taxes	**$ 340**	2,092
Add items not requiring an outlay of funds:		
Depreciation and amortization	**162**	1,342
Equity loss	**281**	1,016
Working capital provided by discontinued operations	**$ 103**	266

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1985 ($000's)	1985	1984
Cash provided by (used in)		
Operations	$ 12,417	15,308
Financing	2,615	1,598
Capital Investments	(15,693)	(12,637)
Shareholder Distributions	(46)	(35)
Increase (decrease) in cash due to non-cash transactions	(707)	4,234
Increase in cash due to unrealized exchange gain on self-sustaining foreign investments during the year	748	—
Cash (deficiency), beginning of year	4,020	(214)
Cash, end of year	$ 4,061	4,020

Financing		
Long-term debt, including current portion, issued	$ 23,221	77,260
Long-term debt, including current portion, repaid	(25,834)	(76,020)
Redemption of Class B special shares (note 15)	(735)	—
Issuance of Class C and Class F shares (note 9)	1,623	374
Issuance of Employee Preference Shares (note 9)	4,350	—
Redemption of preference shares of a subsidiary	(10)	(16)
Cash provided by financing	$ 2,615	1,598

Capital Investments		
Net (increase) reduction:		
Mortgages and long-term receivables	$ (6,089)	(30,456)
Real estate, hotel and other investments	(2,266)	(5,373)
Proceeds on sale of real estate	—	1,055
Proceeds on sale of hotel investments (note 14)	6,463	37,498
Proceeds on sale of other investments	745	—
Purchase of fixed assets	(13,810)	(13,275)
Other assets	(736)	(2,086)
Cash used in capital investments	$ (15,693)	(12,637)

Shareholder Distributions		
Dividends paid on special shares	$ (46)	(35)

The definition of cash for this statement is cash and short-term investments less bank indebtedness.

See accompanying notes to consolidated financial statements.

Consolidated Statement of Retained Earnings

Year ended December 31, 1985 ($000's)	**1985**	1984
Retained earnings, beginning of year	**$ 26,405**	21,273
Net earnings for the year	**4,657**	5,167
Dividends on special shares	**(46)**	(35)
Redemption of Class B shares (note 15)	**(525)**	—
Retained earnings, end of year	**$ 30,491**	26,405

See accompanying notes to consolidated financial statements.

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, 1985 and the consolidated statements of operations, retained earnings, cash provided by operations and changes in financial position 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, 1985 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 7, 1986

Compilation Report

To the Shareholders of Four Seasons Hotels Inc.

We have reviewed, as to compilation only, the accompanying unaudited consolidated pro-forma balance sheet of Four Seasons Hotels Inc. as at December 31, 1985 which has been prepared for inclusion in the Corporation's Annual Report to the Shareholders. In our opinion, the pro-forma balance sheet has been properly compiled to give effect to the proposed transactions and the assumptions described in note 1(h) thereto.

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

Toronto, Canada
March 7, 1986

December 31, 1985 ($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, 1985 the Corporation managed 18 hotels and a sports club and had an equity interest in 13 of these 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.

The Corporation's investments in real estate partnerships and joint ventures are recorded on the equity basis (note 12). Investments in other companies and partnerships are accounted for by the cost method.

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 and equipment, leasehold interests and improvements are recorded at cost less accumulated depreciation and amortization.

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

Tableware and non-circulating linen and uniforms — at the lower of average cost and replacement cost

Circulating linen and uniforms — 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 and in note 12, regarding discontinued operations. Consolidated revenues are calculated as the sum of fee revenues and revenues from hotel ownership operations less inter-segment fee expenses included in the expenses of the hotel ownership and discontinued operation segments.

(h) Pro-forma balance sheet:

The pro-forma balance sheet as at December 31, 1985 reflects the following transactions as if they had occurred on December 31, 1985:

(i) All issued and outstanding shares, except the Employee Preference Shares, were converted to Multiple Voting Shares and Subordinate Voting Shares (note 9).

(ii) The purchase for cancellation of certain of the Corporation's Multiple Voting Shares; the consideration for which is the transfer of certain non-essential assets with a book value at December 31, 1985 of $59,111, and the assumption of certain debts related to these assets in the amount of $21,749 (note 12). The excess of the net consideration paid over the recorded stated capital of the Multiple Voting Shares purchased, which was $36,348, has been applied against the Corporation's retained earnings.

(iii) The issuance by the Corporation of Subordinate Voting Shares for total net proceeds of $30,225 (note 9 and 17). These proceeds were applied as follows:

Reduction of long-term debt, current portion	$ 9,273
Reduction of long-term debt	10,765
Increase in short-term investments	10,187
	$ 30,225

(iv) Pro-forma earnings per share:

	Year ended December 31, 1985
Before extraordinary items	
– basic	$ 0.54
– fully diluted	$ 0.54
After extraordinary items	
– basic	$ 0.67
– fully diluted	$ 0.65

2. Receivables:

	1985	1984
Trade accounts	$ 11,621	11,237
Receivable from hotel partnerships, affiliates and managed hotels	5,364	2,014
Current portion of mortgages receivable due from officers and employees in respect of interest-free house mortgage loans	624	281
Other	70	1,700
	$ 17,679	15,232

At December 31, 1985, receivables in the amount of $2,562 have been transferred to discontinued assets (note 12).

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. Mortgages receivable:

Included in the mortgages receivable of $8,944 is an amount of $2,386 (1984 – $2,649) 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%.

A mortgage in the amount of $3,600 matures in 1990. The remainder of the mortgages receivable mature after 1990.

At December 31, 1985 mortgages and long-term receivables in the amount of $43,032 have been transferred to discontinued assets (note 12).

5. Hotel investments:

(a) Hotel partnerships and managed hotels:

The Corporation's investment in hotel partnerships and managed hotels of $9,787 (1984 – $7,421) represents capital investments, advances and development costs for hotels which are carried on a cost basis.

(b) Hotel joint ventures:

In addition, the following amounts included in the consolidated financial statements represent the Corporation's proportionate share of hotel joint ventures:

Summary Balance Sheet
As at December 31, 1985

ASSETS	1985	1984
Current assets	$ 1,930	2,605
Fixed assets:		
Land, building and equipment, at cost	18,224	17,085
Accumulated depreciation	(6,383)	(5,131)
	11,841	11,954
Other assets	376	553
	$ 14,147	15,112

LIABILITIES AND EQUITY	1985	1984
Current liabilities	$ 3,063	2,751
Long-term debt	7,640	6,690
	10,703	9,441
Corporation's equity	3,444	5,671
	$ 14,147	15,112

Summary Statement of Operations
Year ended December 31, 1985

	1985	1984
Hotel revenues	$ 18,296	16,861
Cost of sales and expenses	16,581	15,636
Depreciation and amortization	1,304	1,010
Earnings before interest and taxes — hotels	411	215
Interest on long-term debt	797	922
Loss from consolidated hotel joint ventures	$ (386)	(707)

6. Fixed assets:

	1985	1984
Land	$ 2,034	1,034
Buildings	10,126	5,734
Furniture, fixtures and equipment	46,464	45,387
Leasehold interests and improvements	36,569	35,115
	95,193	87,270
Accumulated depreciation and amortization	(28,510)	(25,263)
	66,683	62,007
Operating equipment	5,452	5,612
	$ 72,135	67,619

7. Long-term debt:

	Pro-forma (Note 1(h)) (unaudited)	1985	1984
Term bank loans:			
Payable in Canadian funds, interest at bank prime plus 1%	$ –	–	3,868
Payable in Canadian funds, interest at 13¾%, secured by mortgages receivable on a hotel property, due 1995	–	–	18,500
Payable in United States funds — $5,335 (1984 – $2,336) interest at a chartered bank Eurodollar rate plus 1½%	–	7,456	3,085
Payable in Pounds Sterling — pro-forma – 4,667 (1985 and 1984 – 5,523) interest rates at L.I.B.O.R. plus ⅞% secured by a floating charge on the Corporation's Canadian property and assets, a first charge on a specific property and a second charge on a hotel lease	9,418	11,146	8,434
Payable in Pounds Sterling 15,000 (1984 – 15,000) interest at 12%, secured by a hotel lease and the shares of a subsidiary company, due 1991	30,270	30,270	22,905
Debentures:			
Secured by fixed and floating charges on specific hotel properties, due on January 29, 2000, interest at bank prime rate plus 1½%	–	9,023	9,083
Secured by fixed charges on specific properties, interest at 10½%, due in 1984	–	–	876
Series A Sinking Fund Debentures:			
Secured by a first floating charge on all of the Corporation's assets situated in Ontario (subject only to prior encumbrances) and by a bank guarantee, due February 3, 1989, interest at 8%	–	1,750	2,000
Mortgages:			
Secured by fixed charges on a specific property, due subsequent to 1990, interest bank prime plus ½%	5,333	5,333	5,333
Secured by fixed charges on a specific property, due on various dates to 1996, interest at 7¼% and 9½%	–	–	3,757
Notes payable:			
Payable in Canadian funds, due on various dates to 1993, interest at rates varying from 6% to 14% with weighted average rate of 8.4% (1984 – 10.4%)	1,191	1,538	3,513
Deferred foreign exchange credits	1,384	1,118	825
Other long-term liabilities	2,538	2,538	2,798
	50,134	70,172	84,977
Due within one year	9,669	18,942	18,819
	$ 40,465	51,230	66,158

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

	Pro-forma 1985 (Note 1(h)) (unaudited)
1986	$ 9,669
1987	1,316
1988	1,108
1989	497
1990	395
Subsequent to 1990	37,149
	$ 50,134

At December 31, 1985 long-term debt in the amount of $21,666 has been transferred to liabilities related to discontinued assets (note 12).

8. Interest:

Interest expense, net is comprised as follows:

	1985	1984
Interest on long-term debt	$ 11,201	11,096
Other interest expense	303	433
Dividends on preferred shares of a subsidiary	300	232
Interest income	(5,203)	(3,795)
Interest capitalized	(201)	–
	$ 6,400	7,966

9. Shareholders' equity:

(a) Capital Stock:

Authorized at December 31, 1985:

3,500,000 Multiple Voting Shares, voting (twelve votes per share) and ranking equally with Subordinate Voting Shares as to dividends and distributions on liquidation or wind-up of the Corporation. The shares are convertible into Subordinate Voting Shares on a one for one basis at the option of the holder. The shares automatically convert into Subordinate Voting Shares upon any transfer 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 Multiple Voting Shares and Subordinate Voting Shares.

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

290,000 Employee Preference Shares, non-voting and ranking equally (to the extent of issue price plus declared and unpaid dividends) with Multiple Voting Shares and Subordinate Voting Shares 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 Subordinate Voting Shares per Employee Preference Share. 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 Class A shares, voting and participating equally with all other shares as to dividends per share.

1,229,469 Class B shares, voting and participating equally with all other shares as to dividends per share to a maximum of 38 cents per share per annum. Redeemable at $4.75 per share at the option of the holder or the Corporation.

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. At any time after December 31, 1983, up to 1,630 shares may be redeemed at fair market value, at the option of the holder. In the period October 1, 1989 to December 31, 1989, the holder may require the Corporation to redeem on January 31, 1990, that number of Class C shares necessary to yield the holder an amount equal to the amount paid for all Class C shares then outstanding plus all income taxes payable by the holder applicable to such redemption. Such shares shall be redeemed for an amount per share equal to their fair market value. The shares are redeemable at fair market value by the Corporation or the representative of the holder, if the holder dies or becomes permanently incapacitated before July 1, 1989.

Unlimited Class D shares, non-voting and participating equally with all other shares as to dividends per share. The shares are redeemable at $612.86 (based on a calculation as at December 31, 1985) per share at the option of the holder or the Corporation.

Unlimited Class F shares, non-voting and participating equally with all other shares as to dividends per share. Redeemable at $612.86 (based on a calculation as at December 31, 1985) per share at the option of the Corporation at any time. At any time after December 31, 1983 up to 1,630 shares may be redeemed at $612.86 (based on a calculation as at December 31, 1985) per share at the option of the holder, providing a comparable number of Class C shares are required to be redeemed. In the period October 1, 1989 to December 31, 1989, the holder may require the Corporation to redeem on January 31, 1990, that number of Class F shares necessary to yield the holder an amount equal to the amount paid for all Class F shares then outstanding plus all income taxes payable by such holder applicable to such redemptions. Such shares shall be redeemed at $612.86 (based on a calculation as at December 31, 1985) per share. The shares are redeemable at $612.86 (based on a calculation at December 31, 1985) per share by the Corporation or the representative of the holder, if the holder dies or becomes permanently incapacitated before July 1, 1989, provided that all Class C shares are redeemed at the same time.

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.

Issued and fully paid:

	Pro-forma (Note 1(h)) (unaudited)		1985		1984	
	Shares	Stated Value	Shares	Stated Value	Shares	Stated Value
Multiple Voting Shares	2,781,283	$ 61	–	$ –	–	$ –
Subordinate Voting Shares	6,908,002	32,828	–	–	–	–
Employee Preference Shares	290,000	4,350	290,000	4,350	–	–
Class A Special Shares	–	–	–	–	100,000	–
Class B Special Shares	–	–	–	–	1,383,550	1,888
Class C Special Shares	–	–	–	–	5,165	378
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	–	–
		$ 37,239		$ 8,028		$ 2,266

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 Employee Preference Shares for total proceeds of $4,350.

In December 1985, four senior officers of the Corporation were granted options to purchase Subordinate Voting Shares of the Corporation, as described following. There are 800,000 Subordinate Voting Shares under option. 300,000 shares are purchasable at $6.33 per share of which 150,000 are currently exercisable, and 500,000 shares at $12.60 per share, of which all are currently exercisable. The expiry date of the options is December 1995.

Of the options currently not 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.

At December 31, 1985, 168,927 Subordinate Voting Shares were reserved for issuance under an executive share option plan. The eligible executives and employees will be granted options to acquire Subordinate Voting Shares 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.

Subsequent event:

(i) In February 1986, all of the issued and outstanding shares (except the Employee Preference Shares) were reclassified into Multiple Voting Shares on the basis of 45.36870 Multiple Voting Shares for each Class A or Class C Share, 43.77571 Multiple Voting Shares for each Class D or Class F Share and 0.3393 Multiple Voting Shares for each Class B Share. The Multiple Voting Shares held by all holders except Isadore Sharp and his immediate family were converted into Subordinate Voting Shares on a one for one basis. As at March 7, 1986 only the Multiple Voting Shares, Subordinate Voting Shares and Employee Preference Shares are issued and outstanding.

(ii) In February 1986 three senior officers exercised their options to purchase 150,000 Subordinate Voting Shares at $6.33 per share for aggregate consideration of $950.

(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:

	1985	1984
Working capital	$ 323	–
Fixed assets, net	2,925	437
Other assets	154	125
Long-term debt	(4,832)	4,825
Deferred taxes	151	390
Total equity adjustment from foreign currency translation	$ (1,279)	5,777

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:

	1985 %	1984 %
Combined basic federal and provincial income tax rate	49.8	48.7
Income debenture interest excluded in the determination of income for tax purposes	–	13.8
Non-taxable portion of capital losses	–	4.2
Prior years' tax adjustments	–	5.8
Foreign income taxes	–	6.5
Preferred dividends of a subsidiary in net interest	2.1	3.8
Other	(0.5)	2.4
	51.4	85.2

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:

1986	$ 15,922
1987	15,381
1988	16,559
1989	17,231
1990	17,220
Subsequent to 1990	371,930

12. Discontinued operations:

The Corporation has identified certain assets and related liabilities which are 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 is owned by the shareholders of the Corporation at that date as consideration for the purchase for cancellation of the Corporation's Multiple Voting Shares held by this company (note 1(h)). The excess of the book value of the assets transferred, less debts assumed, over the stated capital of the Multiple Voting Shares purchased and cancelled, which was $36,348, was applied to reduce the Corporation's retained earnings. The discontinued net assets which are included in the balance sheet are as follows:

As At December 31, 1985	
Current assets	$ 2,580
Mortgages and long-term receivables	43,032
Real estate investments	8,138
Oil and gas and other investments	5,361
Discontinued assets	$ 59,111
Current liabilities	$ 83
Long-term debt	21,666
Liabilities related to discontinued assets	$ 21,749

The loss before interest and taxes from discontinued operations includes the revenues and expenses attributable to these net assets and the operating results of hotels which were sold during 1984 and 1985 (note 14). The loss before interest and taxes from discontinued operations was as follows:

Year ended December 31, 1985	1985	1984
Revenues	$ 6,421	31,694
Expenses		
Cost of sales and expenses	6,318	30,615
Fees to Hotel Management Operations	–	813
Depreciation and amortization	162	1,342
Share of loss of real estate partnerships and joint ventures	281	1,016
	6,761	33,786
Loss before interest and taxes from discontinued operations	$ 340	2,092

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

(a) mortgages in the aggregate amount of $21,666 as at December 31, 1985;

(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 $5,900 as at December 31, 1985;

(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 and commitments:

(a) The Corporation is contingently liable for all the obligations of certain of the partnerships and joint ventures in which it has a direct interest (note 5). However, against this contingent liability the Corporation would have a claim upon the assets of the partnerships and joint ventures and their partners.

(b) 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 costs 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 $8,385 ($6,000 U.S.) at December 31, 1985.

(c) The Corporation is a defendant in a number of actions for personal injury and property damage arising from a fire that occurred on January 28, 1984 at the former Four Seasons Hotel in Belleville and a fire that occurred on January 17, 1981 at the Inn on the Park, Toronto. The Corporation is of the opinion that its insurance is of the nature and amount sufficient to ensure that the Corporation is fully protected from suffering any financial loss as a result of such claims or future claims.

(d) 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. Due to changing conditions in the insurance industry, the Corporation's policy limits in respect of personal injury insurance coverage will be reduced and the premiums for such coverage will increase substantially. This reduction is not expected, however, to result in the Corporation being subjected to any financial loss as a result of claims incurred by it in the ordinary course of its business.

(e) An action has been filed by a hotel management company for punitive damages claiming that the Corporation interfered with the company's management contracts resulting in lost future fee income and future contractual dealings with a hotel owner.

The amount of the claim has not yet been determined. The Corporation has filed its denial of each and every material allegation of the petition and is of the opinion that this claim is without merit.

(f) The Corporation and five other Ottawa hotel operators were charged in 1985 under the Combines Investigation Act (Canada) relating to an alleged conspiracy to lessen competition and alleged bid-rigging during 1984 by such parties. The charge relating to alleged bid-rigging has subsequently been dropped. The Corporation continues to plead not guilty to the remaining charge.

14. Extraordinary items:

Extraordinary items are as follows:

	1985	1984
Gain on sale of hotel investments, net of income taxes of $657 (i), (1984 – net of income taxes of $5,006)	$ 1,671	9,232
Disposal of hotel investment, net of income taxes recoverable of $131 (ii), (1984 – write-down of Houston investments)	(463)	(4,502)
	$ 1,208	4,730

(i) Effective May 19, 1985 the Corporation sold the assets of its Calgary hotel for $6,463. This included cash of $2,260, debt repaid of $603 and a $3,600 vendor loan.

(ii) On October 31, 1985 the Corporation disposed of its interest in the Inn on the Park, Houston. The Corporation continues to manage this hotel.

15. Related party transactions:

In 1981 the Corporation invested $655 in a company which is controlled by a director and senior officer of the Corporation. The investment is represented by 154,081 Class D non-voting preference shares with a fixed non-cumulative dividend rate of 38 cents per share per annum, redeemable at the option of the Corporation at $4.75 per share.

On November 26, 1985 the Corporation redeemed 154,081 of its Class B shares in exchange for its investment in this related company. The redemption consideration exceeded the recorded stated capital of the Class B shares by $525 which was applied against the Corporation's retained earnings.

16. Segmented information:

	1985	1984
Revenues:		
United States	$ 54,825	55,874
Canada	83,763	77,595
United Kingdom	31,249	25,127
Eliminations	(4,934)	(4,548)
Consolidated revenue	$ 164,903	154,048
Operating profit:		
United States	$ 2,009	3,501
Canada	5,106	3,784
United Kingdom	6,719	5,727
Total operating profit	$ 13,834	13,012
Identifiable assets:		
United States	$ 31,831	33,221
Canada	40,641	48,397
United Kingdom	12,583	11,270
Eliminations	(796)	(1,512)
	84,259	91,376
Corporate assets	28,329	51,686
Investments	10,021	23,132
Discontinued assets	59,111	–
	$ 181,720	166,194

17. Subsequent events:

(a) On February 6, 1986, the Corporation redeemed all of the outstanding Series A Sinking Fund Debentures having a principal balance of $1,750.

(b) On February 12, 1986, the Corporation issued 2,367,857 Subordinate Voting Shares for proceeds of $33,150. The underwriter's fee and the expenses of issue, estimated to be $2,925, will be paid by the Corporation out of its general funds. Proceeds of this issue will ultimately be used to reduce long-term debt.

Description of Hotels

Hotel and location	Date of opening/major renovations	Number of rooms	Management Agreement Initial expiry	Management Agreement Final expiry	Ownership Equity interest	Ownership Title
FOUR SEASONS HOTEL Boston, Massachusetts	1985	288	2010	2085	15%	Freehold
RITZ-CARLTON HOTEL Chicago, Illinois	1975	433	2025	2025	25%	Leasehold
MANDALAY FOUR SEASONS HOTEL Dallas, Texas	1982	424	2002	2042	—	—
LAS COLINAS SPORTS CLUB Dallas, Texas	1983	—	1986	2042	—	—
FOUR SEASONS HOTEL Edmonton, Alberta	1978	314	2003	2028	33%	Leasehold
FOUR SEASONS HOTEL Houston, Texas	1982	399	2016	2046	1%	Freehold
INN ON THE PARK Houston, Texas	1981/1985	383	2015	2075	—	—
INN ON THE PARK London, England	1970	227	2054	2054	100%	Leasehold
LE QUATRE SAISONS Montreal, Quebec	1976/1983	300	2003	2043	—	—
THE PIERRE New York, New York	1929/1981	214	2001	2001	100%	Leasehold
FOUR SEASONS HOTEL Ottawa, Ontario	1972	236	2002	2017	67%	Freehold
FOUR SEASONS HOTEL Philadelphia, Pennsylvania	1983	371	2013	2053	5%	Freehold
FOUR SEASONS HOTEL San Antonio, Texas	1979	250	1998	2053	—	—
FOUR SEASONS CLIFT HOTEL San Francisco, California	1915/1976/1983	329	2006	2066	—	—
FOUR SEASONS OLYMPIC HOTEL Seattle, Washington	1924/1982	450	2040	2040	3%	Leasehold
FOUR SEASONS HOTEL Toronto, Ontario	1974/1979/1984	375	2003	2077	100%	Leasehold
INN ON THE PARK Toronto, Ontario	1963/1971/1985	568	1994	2014	11%	Freehold
FOUR SEASONS HOTEL Vancouver, British Columbia	1976	385	2000	2035	100%	Leasehold
FOUR SEASONS HOTEL Washington, D.C.	1979	197	2007	2022	15%	Freehold

Under development

Hotel and location	Date of opening/major renovations	Number of rooms	Initial expiry	Final expiry	Equity interest	Title
FOUR SEASONS HOTEL Austin, Texas	1987	308	2022	2047	—	—
FOUR SEASONS HOTEL Chicago, Illinois	1989	342	2024	2104	15 to 20 %	Leasehold
LAS COLINAS INN AND CONFERENCE CENTER Dallas, Texas	1986	315	2002	2042	—	—
FOUR SEASONS HOTEL Los Angeles, California	1987	349	2041	2061	—	—
FOUR SEASONS HOTEL Newport Beach, California	1986	319	2016	2046	—	—

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.

FOUR SEASONS HOTELS INC.

Directors and Officers

Isadore Sharp *
Chairman, President and Chief Executive Officer

Edmond M. Creed *
Chairman
Creeds Limited

Frederick Eisen
Executive
Max Sharp & Son Construction Limited

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

Murray B. Koffler * †
Honorary Chairman
Shoppers Drug Mart Limited

Max Sharp
Retired Executive

John L. Sharpe *
Executive Vice-President

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

Christopher Wallis
Senior Vice-President

* Member of Executive Committee

† Member of Audit Committee

FOUR SEASONS HOTELS LIMITED

Management Committee

Isadore Sharp
Chairman, President and Chief Executive Officer

Robert W. Bloch
Senior Vice-President, Marketing

James F. Brown
Senior Vice-President, Operations

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

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

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

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Peat, Marwick, Mitchell & Co.

Legal Counsel
Goodman & Goodman

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The Montreal Exchange

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