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System Fund

System Fund assessments

	2014 $m	2013 $m	2014 vs 2013 % change	2012 $m	2013 vs 2012 % change
	12 months ended 31 December				
Assessment fees and contributions received from hotels	1,271	1,154	10.1	1,106	4.3
Proceeds from sale of IHG Rewards Club points	196	153	28.1	144	6.3
Total	1,467	1,307	12.2	1,250	4.6

In addition to management or franchise fees, hotels within the IHG System pay assessments and contributions which are collected by IHG for specific use within the System Fund. The System Fund also receives proceeds from the sale of IHG Rewards Club points. The System Fund is managed for the benefit of hotels in the IHG System with the objective of driving revenues for the hotels.

The System Fund is used to pay for marketing, the IHG Rewards Club loyalty programme and the global reservation system. The operation of the System Fund does not result in a profit or loss for the Group and consequently the revenues and expenses of the System Fund are not included in the Group Income Statement.

Highlights for the year ended 31 December 2014

In the year to 31 December 2014, System Fund income increased by 12.2% to $1,467m primarily as a result of a 10.1% increase in assessment fees and contributions from hotels resulting from increased hotel room revenues, reflecting increases in RevPAR and IHG System size. Continued strong performance in co-branded credit card schemes drove the 28.1% increase in proceeds from the sale of IHG Rewards Club points.

Highlights for the year ended 31 December 2013

In the year to 31 December 2013, System Fund income increased by 4.6% to $1,307m primarily as a result of growth in hotel room revenues due to increases in RevPAR and IHG System size. The increase in proceeds from the sale of IHG Rewards Club points mainly reflects the continued strong performance of co-brand credit card schemes.

Other financial information

Exceptional operating items

Exceptional operating items totalled a net gain of $29m. The exceptional gain of $130m related to the sale of InterContinental Mark Hopkins San Francisco and the disposal of an 80% interest in InterContinental New York Barclay. Exceptional charges included $14m foreign exchange losses resulting from recent changes to the Venezuelan exchange rate mechanisms and the adoption of the SICAD II exchange rate; $29m relating primarily to structural change programmes across the Global Human Resources and Global Technology functions; $6m arising from a partial cash-out of the UK unfunded pension arrangements; $45m relating to the cost of securing a restructuring of the UK hotel portfolio; and $7m Kimpton Hotels & Restaurants acquisition transaction costs. See note 5 to the Group Financial Statements for further detail.

Exceptional operating items are treated as exceptional by reason of their size or nature and are excluded from the calculation of adjusted earnings per ordinary share in order to provide a more meaningful comparison of performance.

Net financial expenses

Net financial expenses increased by $7m to $80m reflecting an increase in average net debt levels and the translation of interest on the two sterling bonds.

Financing costs included $2m (2013 $2m) of interest costs associated with IHG Rewards Club where interest is charged on the accumulated balance of cash received in advance of the redemption of points awarded. Financing costs in 2014 also included $19m (2013 $19m) in respect of the InterContinental Boston finance lease.

Taxation

The effective rate of tax on operating profit excluding the impact of exceptional items was 31% (2013 29%). Excluding the impact of prior year items the equivalent tax rate would be 35% (2013 32%). This rate is higher than the average UK statutory rate of 21.5% (2013 23.25%) due mainly to certain overseas profits (particularly in the US) being subject to statutory rates higher than the UK statutory rate, unrelieved foreign taxes and disallowable expenses.

Taxation within exceptional items totalled a charge of $29m (2013 $51m). In 2014 the charge comprised $56m relating to the disposal of an 80% interest in InterContinental New York Barclay offset by a credit of $27m relating to a restructuring of the UK hotel portfolio and other reorganisation costs. In 2013 the charge comprised $6m relating to the exceptional operating items and $64m consequent upon the disposal of InterContinental London Park Lane, offset by a credit of $19m relating to an internal restructuring.

Net tax paid in 2014 totalled $136m (2013 $97m) including $nil (2013 $5m) in respect of disposals. Tax paid represents an effective rate of 23% (2013 16%) on total profits and is lower than the effective income statement tax rate of 31% primarily due to the impact of deferred taxes (including the realisation of assets such as tax losses), the receipt of refunds in respect of prior years and provisions for tax for which no payment of tax has currently been made.

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Performance continued

IHG pursues a tax strategy that is consistent with its business strategy and its overall business conduct principles. This strategy seeks to ensure full compliance with all tax filing, payment and reporting obligations on the basis of communicative and transparent relationships with tax authorities. Policies and procedures related to tax risk management are subject to regular review and update and are approved by the Board.

Tax liabilities or refunds may differ from those anticipated, in particular as a result of changes in tax law, changes in the interpretation of tax law, or clarification of uncertainties in the application of tax law. Procedures to minimise risk include the preparation of thorough tax risk assessments for all transactions carrying tax risk and, where appropriate, material tax uncertainties are discussed and resolved with tax authorities in advance.

IHG's contribution to the jurisdictions in which it operates includes a significant contribution in the form of taxes borne and collected, including taxes on its revenues and profits and in respect of the employment its business generates.

IHG earns approximately 70% of its revenues in the form of franchise, management or similar fees, with 85% of IHG branded hotels being franchised. In jurisdictions in which IHG does franchise business, the prevailing tax law will generally provide for IHG to be taxed in the form of local withholding taxes based on a percentage of fees rather than based on profits. Costs to support the franchise business are normally incurred regionally or globally and therefore profits for an individual franchise jurisdiction cannot be separately determined.

Dividends

The Board has proposed a final dividend per ordinary share of 52¢ (33.8p). With the interim dividend per ordinary share of 25¢ (14.8p), the full-year dividend per ordinary share for 2014 will total 77¢ (48.6p), an increase of 10.0% over 2013.

On 2 May 2014, the Group announced a $750m return to shareholders by way of special dividend and share consolidation. The dividend was paid to shareholders on 14 July 2014.

Under the $500m share buyback programme announced on 7 August 2012, which commenced on 12 November 2012 and completed on 29 May 2014, a total of 17.3m shares have been repurchased for total consideration of $500m.

Earnings per ordinary share

Basic earnings per ordinary share increased by 12.3% to 158.3¢ from 140.9¢ in 2013. Adjusted earnings per ordinary share remained unchanged at 158.3¢.

Share price and market capitalisation

The IHG share price closed at £25.95 on 31 December 2014, up from £20.13 on 31 December 2013. The market capitalisation of the Group at the year end was £6.4bn.

Liquidity and capital resources

Sources of liquidity

The Group is financed by a $1.07bn syndicated bank facility which expires in November 2016 (the Syndicated Facility), £250m of public bonds which are repayable on 9 December 2016 and £400m of public bonds which are repayable on 28 November 2022. $361m was drawn under the $1.07bn Syndicated Facility at the year end. The bonds are issued under the Group's £750m Medium Term Notes programme. Short-term borrowing requirements are met from drawings under bilateral bank facilities. Additional funding is provided by the 99-year finance lease (of which 91 years remain) on InterContinental Boston and other uncommitted bank facilities (see note 21 to the Group Financial Statements). In the Group's opinion, the available facilities are sufficient for the Group's present liquidity requirements.

The Syndicated Facility contains two financial covenants; interest cover and net debt divided by earnings before interest, tax, depreciation and amortisation. The Group is in compliance with all of the financial covenants in its loan documents, none of which is expected to present a material restriction on funding in the near future.

Net debt of $1,533m (2013 $1,153m) is analysed by currency as follows:

	2014 $m	2013[1] $m
Borrowings		
Sterling	1,028	671
US dollar	557	709
Euros	103	11
Other	7	10
Cash and cash equivalents		
Sterling	(21)	(87)
US dollar	(54)	(40)
Euros	(25)	(15)
Canadian dollar	(14)	(25)
Chinese renminbi	(8)	(15)
Other	(40)	(66)
Net debt[2]	1,533	1,153
Average debt levels	1,322	985

1 Restated for the adoption of 'Offsetting Financial Assets and Financial Liabilities' (Amendments to IAS 32), see page 107.
2 Including the impact of currency derivatives.

Borrowings included bank overdrafts of $107m (2013 $114m) which were matched by an equivalent amount of cash and cash equivalents under the Group's cash pooling arrangements. Under these arrangements, each pool contains a number of bank accounts with the same financial institution and the Group pays interest on net overdraft balances within each pool. The cash pools are used for day-to-day cash management purposes and are managed daily as closely as possible to a zero balance on a net basis for each pool. Overseas subsidiaries are typically in a cash positive position, with the most significant balances in the US and Canada, and the matching overdrafts are held by the Group's central treasury company in the UK.

Cash and cash equivalents include $4m (2013 $12m) that is not available for use by the Group due to local exchange controls.

Information on the maturity profile and interest structure of borrowings is included in notes 20 and 21 to the Group Financial Statements.

The Group had net liabilities of $717m at 31 December 2014 reflecting that its brands are not recognised in the Group statement of financial position. At the end of 2014 the Group was trading significantly within its banking covenants and facilities.

Cash from operating activities

Net cash from operating activities totalled $543m for the year ended 31 December 2014 down $81m on the previous year largely due to increased cash flows relating to exceptional operating items.

Cash flow from operating activities is the principal source of cash used to fund the ongoing operating expenses, interest payments, maintenance capital expenditure and normal dividend payments of the Group. The Group believes that the requirements of its existing business and future investment can be met from cash generated internally, disposition of assets and external finance expected to be available to it.

Cash from investing activities

Net cash inflows due to investing activities totalled $123m, a decrease of $52m over 2013. Capital expenditure on property, plant and equipment decreased from $159m in 2013 to $84m as the prior year included significant investment in hotel properties that were in the process of being converted to the Group's EVEN Hotels brand. $394m of disposal proceeds primarily related to the disposal of InterContinental Mark Hopkins San Francisco and the disposal of an 80% interest in InterContinental New York Barclay.

The Group had committed contractual capital expenditure of $117m at 31 December 2014 (2013 $83m).

Cash used in financing activities

Net cash used in financing activities totalled $736m, which was $121m lower than in 2013. Returns to shareholders of $1,052m, comprising ordinary dividends, special dividends and share buybacks, were $236m higher than in 2013. $68m (2013 $44m) was spent on share purchases in order to fulfil share incentive awards.

Overall net debt increased during the year by $380m to $1,533m at 31 December 2014.

Off-sheet balance sheet arrangements

At 31 December 2014, the Group had no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Group's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Contractual obligations

The Group had the following contractual obligations outstanding as of 31 December 2014:

	Total amounts committed	Less than 1 year	1-3 years	3-5 years	After 5 years
			$m		
Long-term debt obligations[1, 2]	1,378	3	751	–	624
Interest payable[2]	248	52	76	47	73
Derivatives	2	2	–	–	–
Finance lease obligations[3]	3,364	16	32	32	3,284
Operating lease obligations	349	40	62	47	200
Agreed pension scheme contributions[4]	6	6	–	–	–
Capital contracts placed	117	117	–	–	–
Kimpton acquisition	430	430	–	–	–
Total	5,894	666	921	126	4,181

1 Repayment period classified according to the related facility maturity date.
2 Excluding bank overdrafts.
3 Represents the minimum lease payments related to the 99-year lease (of which 91 years remain) on InterContinental Boston. Payments under the lease step up at regular intervals over the lease term.
4 Largely relates to US pension obligations.

As explained in note 33 to the Group Financial Statements, the Group completed the acquisition of Kimpton Hotel & Restaurant Group, LLC for $430m on 16 January 2015.

The acquisition was primarily financed by a $400m bilateral term loan with a term of six months plus two six-month extension periods. A variable rate of interest is payable on the loan which has identical covenants to the Syndicated Facility.

Contingent liabilities

Contingent liabilities include performance guarantees with possible cash outflows totalling $29m, guarantees over the debt of equity investments of $20m and outstanding letters of credit of $40m. See note 30 to the Group Financial Statements for further details.

Governance

Plan

'Guest Journey' – Step two

- The **Plan** phase of the 'Guest Journey' is where our guests narrow down their travel options.
- They do this in different ways; by searching and learning more about our brands online and reading guest reviews; through IHG Rewards Club offerings; or via interaction with call centres, travel agents and corporate travel departments.


DUBA

Chairman's overview

Dear Shareholder

We are committed to maintaining the highest standards of corporate governance. Our governance framework, led by the Board, supports IHG's culture, values and our commitment to conducting business responsibly, further explained on pages 24 and 25. We have in place strong and effective practices and conduct regular reviews to ensure we are compliant.

Governance and strategy

The Board is accountable for the long-term success of the Group, as well as for setting the strategic priorities and objectives of the Group and its risk appetite. We consider the interests of all of our stakeholders at all times. Shaping and implementing IHG's strategy is the most critical role of the Board and therefore the Board dedicates ample time to discussing the Group's strategy, not least as part of our annual strategy meeting. Further information on how the Board spent its time during 2014 can be found on page 56.

Board changes and succession planning

A high-level structure of IHG's Board and its Committees, along with biographies of current Board and Executive Committee members, can be found on pages 55 and 57 to 61.

As announced in our 2013 Annual Report, David Kappler retired on 31 May 2014 after spending over nine years as a Non-Executive Director at IHG. He was succeeded by Dale Morrison as Senior Independent Non-Executive Director on 31 May 2014. Ian Dyson took over David's duties as Chairman of the Audit Committee on 1 April 2014. We also said goodbye to Jonathan Linen, who retired from the Board on 31 December 2014 after spending nine years with the business.

In August 2014, we announced the appointment of Jo Harlow to the Board and Audit, Nomination and Remuneration Committees effective as of 1 September 2014. Jo's appointment fulfils one of the objectives I highlighted last year, which was to enhance the Board's capabilities and competencies by appointing a Non-Executive Director with specific consumer-facing technology experience given the significance of this area in our strategy.

Finally, in December 2014, we announced Kirk Kinsell would step down from the Board on 13 February 2015. Kirk was succeeded as Chief Executive Officer, The Americas by Elie Maalouf, who sits on IHG's Executive Committee. I would like to thank Kirk for his long-standing contribution to IHG, most recently as a Board member and President of The Americas region.

We are also pleased to welcome Anne Busquet to the Board as a Non-Executive Director effective as of 1 March 2015. Anne will sit on the Audit, Corporate Responsibility and Nomination Committees. Anne has an impressive breadth of experience in digital commerce, hospitality, finance and marketing.

Our Board Committees

We continually review the Board's composition to ensure we have the right balance of skills to support the business both today and in the future. This includes a regular review of the size, experience, diversity and gender of our Board, which is conducted by our **Nomination Committee** (see page 69 for its report). We value the benefits that diversity brings, having had at least 25 per cent female representation on our Board since 2012. Further details on our approach to diversity from Board level and throughout the organisation, including our policies in this area, can be found on pages 61 and 62.

The **Audit Committee** plays a substantial role in ensuring appropriate governance and challenge around our risk and assurance processes. In line with our 2014 priorities, a major focus area has been the risks relating to information security and technology. More information can be found in the Audit Committee Report on pages 65 to 67.

In 2014, the **Corporate Responsibility Committee** continued to drive engagement of our three corporate responsibility programmes and deliver against our five-year corporate responsibility targets (see page 68 for its report).

At our 2014 AGM, our Directors' Remuneration Policy was approved with a 90.94 per cent vote in favour. We are not making any changes to this Policy this year, however, we have provided a summary of it in our **Directors' Remuneration Report**, which can be found on pages 76 to 91. This includes information about the Committee, the Annual Report on Directors' Remuneration and Implementation of our Directors' Remuneration Policy in 2015.

Board effectiveness

For 2014, we conducted an internal evaluation on Board effectiveness. During 2014, we progressed the actions that were highlighted from the 2013 external evaluation, which enabled us to further inform enhancements to our Board processes. Details of both the 2013 and 2014 evaluation, including the process and recommendations, can be found on pages 63 and 64.

Structure of the report

This year we have restructured our Corporate Governance Statement, setting out a review of our 2014 activities at the start, followed by each Board Committee's report and finally details of how we have complied with the UK Corporate Governance Code published in September 2012 (the Code). We have aimed to provide greater transparency on compliance with the Code, making this easier to follow.

I am pleased to report that, during 2014, we complied fully with all principles and provisions of the Code, with the exception of the provision relating to audit tendering (see page 70), as we believe it would not be in the best interests of the Group to undertake an audit tender at this time (see pages 66 and 67).

Objectives for the year

My objectives for the Board this year are to ensure that the focus and composition of the Board continues to evolve to support the execution of our strategy and the opportunities and challenges we face. Our 2015 Board agenda will allow time for continued focus on our technology strategy and in-depth reviews of our brands and our priority markets. This year, our annual strategy meeting will be held in Greater China.

Patrick Cescau
Non-Executive Chairman
16 February 2015

Compliance and our dual listing

As a dual listed company with a premium listing on the London Stock Exchange and a secondary listing on the New York Stock Exchange, we are required to file both an Annual Report in the UK, which complies with the Code, and an Annual Report on Form 20-F in the US, which complies with the NYSE rules, US securities laws and the rules of the Securities and Exchange Commission (SEC).

For 2014, to ensure continued consistency of information provided to both UK and US investors, we have for the second time produced a combined Annual Report and Form 20-F.

As required by the SEC, a statement outlining the differences between the Group's UK corporate governance practices and those followed by US companies can be found on pages 173 and 174.

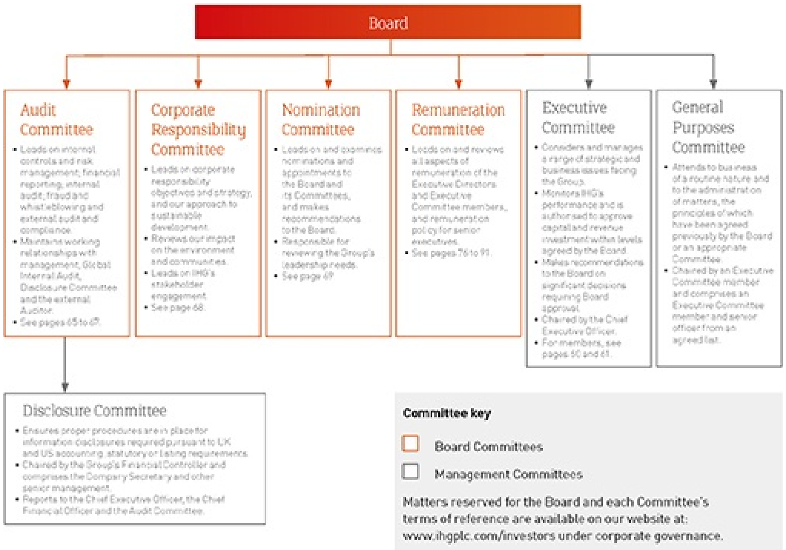
Corporate Governance

Our Board and Committee governance structure

The Board leads the strategic direction and long-term objectives and success of the Group through effective oversight and review, setting the Group's strategic aims and monitoring the performance of the Group and its risk management controls.

A number of key decisions and matters are reserved for the Board's approval and are not delegated to management, these include matters related to Group business and commercial strategy; significant investment proposals; maintaining an overview and control of the Group's operating and financial performance; monitoring the Group's overall system of internal controls and risk management and governance and compliance.

The Board delegates certain responsibilities to its Committees, namely the Audit Committee, Corporate Responsibility Committee, Nomination Committee and Remuneration Committee, to assist it in carrying out its functions.



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