HILTON HOTELS CORP
Form 10-K
March 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended December 31, 2005
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 1-3427

HILTON HOTELS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	**36-2058176** (I.R.S. Employer Identification Number)
9336 Civic Center Drive **Beverly Hills, California** (Address of principal executive offices)	**90210** (Zip Code)

Registrant s telephone number, including area code: **(310) 278-4321**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $2.50 per share	New York
8% Quarterly Interest Bonds due 2031	New York

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes o No x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

Based upon the June 30, 2005, New York Stock Exchange closing price of $23.85 per share, the aggregate market value of the Registrant s outstanding Common Stock held by non-affiliates of the Registrant was approximately $8.4 billion. There were 380,750,582 and 383,206,609 shares of Common Stock outstanding as of June 30, 2005 and February 28, 2006, respectively.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of Registrant s definitive proxy statement, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the Registrant s fiscal year, are incorporated by reference under Part III.

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PART I

Item 1. Business

GENERAL INFORMATION

Current Operations

Hilton Hotels Corporation is engaged, together with its subsidiaries, in the ownership, management and development of hotels, resorts and timeshare properties and the franchising of lodging properties. As of December 31, 2005, our system contained 2,388 properties with approximately 375,000 rooms. Of such properties, we owned an interest in and operated 84 hotels, leased six hotels, managed 210 hotels owned by others and franchised 2,054 hotels owned and operated by third parties. Also included in the number of properties in our system are 34 timeshare properties which we managed or franchised. All of these properties are located in the United States, with the exception of 16 hotels in which we own an interest and/or manage and 63 hotels that we franchise.

At December 31, 2005, our hotel brands included Hilton, Hilton Garden Inn, Doubletree, Embassy Suites, Homewood Suites by Hilton, Hampton and Conrad. We develop and operate timeshare resorts through Hilton Grand Vacations Company and its related entities, which we wholly own. We are also engaged in various other activities related or incidental to the operation of hotels.

Hilton was organized in the State of Delaware on May 29, 1946. Our principal executive offices are located at 9336 Civic Center Drive, Beverly Hills, California 90210, and our telephone number is (310) 278-4321.

Acquisition of Hilton International

On February 23, 2006, we consummated our previously announced acquisition of the lodging assets of Hilton Group plc (the HI Acquisition) operated by its subsidiary, Hilton International Co. (HI), for approximately £3.3 billion, equivalent to approximately $5.78 billion on the transaction date, in an all-cash transaction. As a result of the HI Acquisition, we believe we are the largest, by revenue, and most geographically diverse lodging company in the world, with nearly 2,800 hotels and approximately 475,000 rooms in 80 countries. The HI properties that we acquired consist of 387 hotels with over 100,000 rooms, of which 41 hotels are owned, 194 are leased, eight are partially owned through joint ventures, 115 are managed and 29 are franchised. The hotels we acquired in the HI Acquisition consist of 253 properties operated under the Hilton brand, 128 properties operated under the mid-market Scandic brand, four properties operated under the Coral by Hilton resort brand, one property under the Conrad brand and one property operated under an independent brand. We also acquired 80 LivingWell health clubs, primarily in Europe, and four timeshare properties. As a result of the HI Acquisition, we now wholly own the Hilton HHonors Worldwide frequent guest program and the Hilton Reservations Worldwide reservation system, both of which were previously owned equally by HI and us. We also obtained worldwide ownership of the luxury Conrad hotel brand, which had been operated as a joint venture between HI and us since 2002. As a result of the HI Acquisition, we now own all the rights to the Hilton and Conrad brands, including the right to develop these brands on a worldwide basis.

Recent Developments

Hotel Properties

- In 2005, we sold 20 wholly or majority owned properties for approximately $1.082 billion, and retained management or franchise agreements on all but one of the properties. The properties sold in 2005 included 15 Hiltons, two Homewood Suites by Hilton, one Doubletree, one Embassy Suites and one independent hotel.

- In February 2006, we commenced management of the Grand Wailea Resort Hotel & Spa in Maui, Hawaii, the Arizona Biltmore Resort & Spa in Phoenix, Arizona and the La Quinta Resort & Club in La Quinta, California. These properties are included in our new Waldorf=Astoria Collection of luxury hotels, along with the Waldorf=Astoria in New York, New York.

- In 2005, Hampton Inn, Hilton Garden Inn (for the fourth straight year) and Homewood Suites by Hilton (for the third straight year) each earned first place rankings for customer satisfaction in their respective categories from J.D. Power and Associates. Hilton was the only hotel company with three brands earning top rankings. In addition, the Hilton, Doubletree and Embassy Suites brands all improved their respective customer satisfaction scores in the 2005 J.D. Power study.

Timeshare Properties

- We are continuing to develop a 1,582-unit timeshare resort in Las Vegas, Nevada, with phase two of this project consisting of a 38-story, 423-unit tower, scheduled to open in summer 2006.

- We have opened 236 units of a 456-unit timeshare resort in Orlando, Florida, with an additional 70 units scheduled to open in spring 2006.

- We are continuing to develop a new 120-unit timeshare resort in Waikoloa, Hawaii, 22 units of which opened in 2005, with the remaining units scheduled for completion in spring 2006.

Additional Information

For a description of our planned expansion activities, see Operations Development. For additional information, see Development and Capital Spending under Item 7.

Industry Segments

As of December 31, 2005, we operated in three reportable business segments which are based on similar products or services: Hotel Ownership; Managing and Franchising; and Timeshare. For additional information, see Note 16: Segment Information to the consolidated financial statements under Item 8.

As of December 31, 2005, we managed (and in some cases, partially owned) hotel properties in Belgium, Egypt, England, Hong Kong, Indonesia, Ireland, Mexico, Puerto Rico, Singapore, Thailand and Turkey. We also franchised hotel properties in Canada, Colombia, Costa Rica, Dominican Republic, Ecuador, Mexico, Peru, Puerto Rico and Venezuela. Through December 31, 2005, the amounts of revenue, operating profits and assets attributable to geographic areas outside the United States have not been material.

OPERATIONS

Hotel Properties

Owned Hotels

As of December 31, 2005, we owned a majority or controlling financial interest in and operated 30 hotels, representing 22,971 rooms. The owned hotels include our largest and most profitable hotels, including:

- the 1,416-room Waldorf=Astoria;

- the 1,980-room Hilton New York;

- the 2,860-room Hilton Hawaiian Village;

- the 1,240-room Hilton Waikoloa Village;
- the 1,908-room Hilton San Francisco;
- the 1,544-room Hilton Chicago;
- the 1,119-room Hilton Washington; and
- the 1,572-room Hilton New Orleans Riverside.

We lease the land upon which eight of our owned hotels are located. The expiration dates of the leases range up to 2091, with certain leases containing renewal options for 30 to 40 years. Under these leases, we own the buildings and leasehold improvements and all furniture and equipment; we are responsible for repairs, maintenance, operating expenses and lease rentals; and we retain complete managerial discretion over operations. Lease terms generally require us to pay a fixed monthly base rent and may require us to pay additional rent based on a percentage of revenue or income from the hotel. Upon the expiration of such leases, the buildings and other leasehold improvements presently owned by us revert to the landlords. For additional information, see Note 17: Leases to the consolidated financial statements under Item 8.

Leased Hotels

As of December 31, 2005, we leased six hotels, representing 2,245 rooms. Under these leases, we lease the hotel from its owner, manage the hotel and are generally responsible for all aspects of the hotel s operations and recognize all revenues and substantially all expenses associated with the hotel s operations. Although, in general, replacement of furniture, fixtures and equipment is the landlord s responsibility, we are obligated under certain leases to maintain and replace these items. Lease terms typically require us to pay a fixed monthly base rent regardless of the performance of the hotel and a variable rent based on a percentage of revenue or income. For additional information, see Note 17: Leases to the consolidated financial statements under Item 8.

Joint Ventures

As of December 31, 2005, we had a minority or non-controlling financial interest in and operated 54 hotels, representing 17,040 rooms. We have a right of first refusal to purchase additional equity interests in certain of these joint ventures. We manage each of the partially owned hotels for the entity owning the hotel. For additional information, see Alliances below.

Managed Hotels

As of December 31, 2005, we managed 210 hotels, representing 53,115 rooms, which are wholly owned by others. Under our standard management agreement, we operate a hotel for the benefit of its owner, which either owns or leases the hotel and the associated personal property. Our management fee is generally based on a percentage of each hotel s gross revenue plus, for the majority of properties, an incentive fee based on operating performance. The terms of our management agreements are for various periods and generally contain renewal options, subject to certain termination rights.

In general, under our management agreements all operating and other expenses are paid by the owner and we are reimbursed for our out-of-pocket expenses. In turn, our managerial discretion is subject to approval by the owner in certain major areas, including the approval of capital expenditure budgets.

Franchise Hotels

As of December 31, 2005, we franchised 2,054 hotels, representing 275,350 rooms, which are owned and operated by third parties. In general, franchisees pay us an initial fee based on the number of rooms in a franchise hotel and a continuing fee based on a percentage of the hotel s rooms revenue, which may be up to five percent of rooms revenue depending on the brand. Although we do not directly participate in the management or operation of franchise hotels, we conduct periodic inspections to ensure that our standards are maintained and render advice with respect to certain aspects of hotel operations. We generally approve the plans for, and the location of, franchise hotels and assist in their design.

Hotel Brands

We operate hotels through the brands described below, which target a wide variety of markets and geographic areas. According to data from Smith Travel Research, in 2005, our Hilton, Hilton Garden Inn, Embassy Suites, Homewood Suites by Hilton and Hampton brands all commanded significant market share premiums in the system-wide revenue per available room (RevPAR) index, which represents the share of

RevPAR these properties attain versus their respective competitive sets.

Hilton

Hilton hotels are our upscale, full-service hotels that typically include swimming pools, gift shops and retail facilities, meeting and banquet facilities, restaurants and lounges, room service, parking facilities and other services. The Hilton brand also includes Hilton Suites hotels which are upscale, all-suite hotels. As of December 31, 2005, there were 234 Hilton hotels, representing 90,478 rooms, located in 38 states, the District of Columbia, Canada and Mexico. As of December 31, 2005, there were 12 Hilton hotels under construction in the U.S., of which 10 will be franchise hotels and two will be managed hotels.

Hilton Garden Inn

Hilton Garden Inn hotels are our upper mid-market, focused service hotels that utilize a modular design constructed around a courtyard containing an indoor or outdoor swimming pool. In 2005, the Hilton Garden Inn brand earned the first place J.D. Power Award for Highest Customer Satisfaction in its category for a fourth consecutive year. As of December 31, 2005, there were 259 Hilton Garden Inn hotels, representing 35,523 rooms, located in 39 states, the District of Columbia, Canada and Mexico. As of December 31, 2005, 41 Hilton Garden Inn hotels were under construction, all of which will be franchise hotels.

Doubletree

Doubletree hotels are our full-service hotels in the mid-market to upscale hotel category. The Doubletree brand also includes the Doubletree Guest Suites all-suite hotels and the moderately priced Doubletree Club hotels. As of December 31, 2005, there were 160 Doubletree hotels, representing 42,168 rooms, located in 36 states, the District of Columbia, Canada and Latin America. As of December 31, 2005, nine Doubletree hotels were under construction, all of which will be franchise hotels.

Embassy Suites

Embassy Suites are our upscale, all-suite hotels that feature two-room guest suites with a separate living room and dining/work area and a complimentary cooked-to-order breakfast. Most Embassy Suites hotels are built around a landscaped atrium. As of December 31, 2005, there were 182 Embassy Suites, representing 44,429 rooms, located in 38 states, the District of Columbia, Canada, Dominican Republic, Puerto Rico and Latin America. As of December 31, 2005, six Embassy Suites hotels were under construction, of which five will be franchise hotels and one will be a managed hotel.

Homewood Suites by Hilton

Homewood Suites by Hilton are our upscale, extended-stay hotels that feature residential style accommodations including business centers, swimming pools, convenience stores and limited meeting facilities. In 2005, the Homewood Suites by Hilton brand earned the first place J.D. Power Award for Highest Customer Satisfaction in its category for the third consecutive year. As of December 31, 2005, there were 164 Homewood Suites, representing 18,133 rooms, located in 37 states, the District of Columbia and Canada. As of December 31, 2005, 37 Homewood Suites hotels were under construction, all of which will be franchise hotels.

Hampton

Hampton Inn hotels are our moderately priced hotels with limited food and beverage facilities. The Hampton brand also includes Hampton Inn & Suites hotels which offer both traditional hotel room accommodations and apartment style suites within one property. In 2005, the Hampton brand earned the first place J.D. Power Award for Highest Customer Satisfaction in its category. As of December 31, 2005, there were 1,336 Hampton hotels, representing 134,121 rooms, located in 49 states, Canada, Puerto Rico and Latin America. As of December 31, 2005, 103 Hampton hotels were under construction, of which 101 will be franchise hotels and two will be managed hotels.

Other Brands

In addition to the hotel brands described above, as of December 31, 2005, we operated 19 hotels, representing 5,869 rooms, operated under our Conrad brand or under third party brands pursuant to contractual arrangements. Conrad hotels are our upscale, full-service hotels located primarily outside the United States. As of December 31, 2005, we managed, and in some cases partially owned, 14 Conrad hotels, representing 4,766 rooms, located in Chicago, Illinois, Miami, Florida and Belgium, Egypt, England, Hong Kong, Indonesia, Ireland, Singapore, Thailand and Turkey. As of December 31, 2005, three Conrad hotels were under construction, all of which will be managed hotels.

In early 2006, we introduced a new brand line, the Waldorf=Astoria Collection. This new, elite brand designation debuts with New York s legendary Waldorf=Astoria, along with three world-class luxury resorts which are newly managed by us: the Grand Wailea Resort Hotel & Spa on the island of Maui in Hawaii; the Arizona Biltmore Resort & Spa in Phoenix, Arizona; and the La Quinta Resort & Club in La Quinta, California. We anticipate that the Waldorf=Astoria Collection will grow primarily through branding of existing landmark or boutique hotels, co-branding of existing Hilton and Conrad hotels and opening newly built properties in select cities.

Timeshare Operations

We conduct our timeshare operations through Hilton Grand Vacations Company and its related entities (HGVC), which we wholly own. As of December 31, 2005, HGVC operated 21 timeshare resorts in Florida, four in Hawaii, three in Nevada and one in each of Colorado and New York. We also manage one timeshare resort and franchise three timeshare resorts in the United States under the Embassy Vacation Resort name. In addition, HGVC operates HGVClub and Hilton Club, points-based reservation and exchange systems with 34 affiliated timeshare resorts.

Development

Hotel Properties

We intend to grow our hotel system through the HI Acquisition (see Note 20: Subsequent Events to the consolidated financial statements under Item 8), franchising and the addition of management contracts. We will also continue to invest in capital improvements and select projects at our owned hotels. In addition, we may seek to acquire ownership interests in hotel properties on a strategic and selective basis, either directly or through investments in joint ventures. See Alliances below.

During 2005, we added a total of 175 hotel and timeshare properties, primarily franchises, with approximately 25,000 rooms to our system. A total of 46 properties, primarily franchises, with approximately 8,000 rooms, were removed from our system in 2005.

Total hotel property additions to our system in 2005 included 163 franchise properties and nine managed properties owned by third parties. These additions included 34 properties which, due in part to the market share leadership of our brands, were converted to our family of brands in 2005. The 34 conversions included 17 Doubletrees, seven Hiltons, four Hilton Garden Inns, two Hamptons, two Homewood Suites by Hilton, one Embassy Suites and one Conrad.

In 2006, we expect to add approximately 200 hotels and 28,000 rooms to our hotel system, with Hampton and Hilton Garden Inn accounting for most of the new development. We expect virtually all of this growth to be through franchise and management agreements. This growth excludes potential new international development opportunities as a result of the HI Acquisition.

Our current development pipeline is our biggest yet, with approximately 600 hotels, primarily franchises, with 78,000 rooms, at December 31, 2005, not including potential international development associated with the HI Acquisition. The consummation of transactions in our development pipeline is subject to certain conditions and uncertainties.

Our ability to grow the number of managed and franchised hotels is affected by the factors set forth below under Item 1A Risk Factors, including but not limited to international, national and regional economic conditions; the effects of actual and threatened terrorist attacks and international conflicts; acts of God, such as natural disasters; credit availability; relationships with franchisees and property owners; and competition from other hotel brands.

Timeshare Properties

HGVC has recently opened or is currently developing the following projects:

- HGVC is continuing to develop a 120-unit timeshare resort in Waikoloa, Hawaii, near the Hilton Waikoloa Village, 22 units of which opened in 2005, with the remaining units scheduled for completion in spring 2006.

- HGVC is continuing to develop a 1,582-unit timeshare resort located at the north end of the Las Vegas Strip in Las Vegas, Nevada. Phase two of this project, consisting of 423 units, is scheduled to open in summer 2006. Upon the opening of phase two, approximately 44% of the planned four-tower project will have been completed.

- HGVC is continuing to develop a timeshare resort at Tuscany Village on International Drive in Orlando, Florida, with seven phases and a total of 456 units. The first four phases of this project, consisting of 236 units, have opened and the fifth phase of this project, consisting of 70 units, is scheduled to be completed in spring 2006. Also in Orlando, HGVC is adding 48 units to its existing property adjacent to Sea World.

HGVC is actively seeking new management, development and acquisition opportunities in other destination markets. For additional information, see Note 2: Summary of Significant Accounting Policies to the consolidated financial statements under Item 8.

Alliances

Hilton Group

In 1997, we entered into agreements with Hilton Group plc whose wholly owned subsidiary, HI, owned the rights to the Hilton name outside the United States. The agreements provided for the reunification of the Hilton brand worldwide through a strategic alliance between the companies, including cooperation on sales and marketing, loyalty programs and other operational matters. Pursuant to these agreements, both companies integrated their reservation systems under Hilton Reservations Worldwide, launched the Hilton HHonors Worldwide loyalty program, integrated worldwide sales offices, developed joint marketing initiatives and adopted a Hilton brand identity used by both companies. As a result of the HI Acquisition, we acquired all of HI s hotel properties and Hilton Reservations Worldwide and Hilton HHonors Worldwide are now wholly owned by us. See General Information Acquisition of Hilton International, Additional Information Reservation System and HHonors.

In the first quarter of 2005, we announced an initiative with HI to develop the luxury Conrad brand on a global basis. The development of the Conrad brand was through a joint venture company owned equally by HI and us. The joint venture sought to develop the Conrad brand primarily through management agreements. As a result of the HI Acquisition, we now own all the rights to the Hilton and Conrad brands, including the right to develop Hilton, Conrad and our other brands on a worldwide basis. See Territorial Restrictions below.

CNL Joint Ventures

Since 2001, we have entered into three separate joint venture partnerships with CNL Hospitality Corporation (CNL). The three partnerships own thirteen properties comprising eight Hiltons, four Embassy Suites and one Doubletree (see Note 3: Acquisitions and Dispositions in the notes to the consolidated financial statements under Item 8).

FelCor

As of December 31, 2005, FelCor Lodging Trust Inc. (FelCor) owned or had an interest in 70 of our hotels and we owned approximately 1.5 million shares of FelCor common stock, representing approximately 2% of FelCor s outstanding common stock.

Development Financing

We have established franchise financing programs with third party lenders to support the growth of our Hilton Garden Inn, Homewood Suites by Hilton, Hampton and Embassy Suites hotels. As of December 31, 2005, we have provided guarantees of $35 million on loans outstanding under these programs. In addition, we have guaranteed $36 million of debt and other obligations of unconsolidated affiliates and third parties, bringing our total guarantees to approximately $71 million. Our outstanding guarantees have terms of one to seven years. We also have commitments under letters of credit totaling $56 million as of December 31, 2005. We believe it is unlikely that material payments will be required under our outstanding guarantees or letters of credit. See Note 18: Commitments and Contingencies to the consolidated financial statements under Item 8.

Territorial Restrictions

Pursuant to an agreement entered into in 1964 at the time we distributed all of the issued and outstanding capital stock of HI to our stockholders, we were prohibited from operating facilities outside the United States identified as Hilton hotels and HI was prohibited from operating facilities within the United States identified as Hilton hotels. We entered into alliance agreements with Hilton Group plc, the parent company of HI, pursuant to which HI granted a license to us to develop franchise properties under the Hilton and Hilton Garden Inn names in Canada, Mexico and the Island of St. John, U.S. Virgin Islands. As a result of the HI Acquisition (see Note 20: Subsequent Events to the consolidated financial statements under Item 8), we now own the right to develop each of these brands on a worldwide basis. See Alliances Hilton Group above.

We have also entered into certain management and franchise agreements that contain provisions which may restrict our right to own, manage or franchise additional hotels in specified geographic areas.

Potential Acquisitions

On February 23, 2006, we consummated the HI Acquisition. See General Information Acquisition of Hilton International above. We continue to evaluate other acquisition opportunities and may, from time to time, negotiate to engage in a business combination transaction or other acquisition. However, there is no assurance that we will engage in any such transactions.

Property Transactions

We will continue to review our owned hotel portfolio for potential repositioning or rebranding opportunities. It is our intention to be opportunistic when evaluating potential asset sales and we will look to sell particular hotel properties to the extent we can obtain premium prices. We are currently marketing for sale certain of our owned properties. See Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8.

Seasonality

The hospitality industry is seasonal in nature. However, the periods during which our properties experience higher or lower levels of demand vary from property to property and depend principally upon location.

Statistical Information

The following table sets forth certain system-wide information for our properties with respect to the number of properties and rooms as of December 31, 2004 and 2005:

	2004 Number of Properties	Rooms	2005 Number of Properties	Rooms	Change in Number of Properties	Rooms
Hilton						
Owned	36	27,492	21	20,524	(15)	(6,968)
Leased	1	499	1	499		
Joint Venture	10	4,177	11	4,625	1	448
Managed	24	13,822	27	15,923	3	2,101
Franchised	159	43,266	174	48,907	15	5,641
Total	230	89,256	234	90,478	4	1,222
Hilton Garden Inn						
Owned	1	162	1	162		
Joint Venture	1	128	1	128		
Managed	6	796	7	886	1	90
Franchised	211	28,755	250	34,347	39	5,592
Total	219	29,841	259	35,523	40	5,682
Doubletree						
Owned	4	1,702	3	1,349	(1)	(353)
Leased	6	2,144	5	1,746	(1)	(398)
Joint Venture	24	7,208	14	4,306	(10)	(2,902)
Managed	38	10,074	30	8,060	(8)	(2,014)
Franchised	82	19,794	108	26,707	26	6,913
Total	154	40,922	160	42,168	6	1,246
Embassy Suites						
Owned	4	881	3	663	(1)	(218)
Joint Venture	27	7,279	25	6,586	(2)	(693)
Managed	54	14,134	56	14,832	2	698
Franchised	90	20,421	98	22,348	8	1,927
Total	175	42,715	182	44,429	7	1,714
Homewood Suites by Hilton						
Owned	3	398	1	140	(2)	(258)
Managed	36	4,304	41	4,706	5	402
Franchised	104	11,352	122	13,287	18	1,935
Total	143	16,054	164	18,133	21	2,079
Hampton						
Owned	1	133	1	133		
Managed	35	4,462	34	4,453	(1)	(9)
Franchised	1,254	125,803	1,301	129,535	47	3,732
Total	1,290	130,398	1,336	134,121	46	3,723
Other(1)						
Owned	1	300			(1)	(300)
Joint Venture	3	1,394	3	1,395		1
Managed	13	3,788	15	4,255	2	467
Franchised			1	219	1	219
Total	17	5,482	19	5,869	2	387
Timeshare	31	3,740	34	3,948	3	208
Total						
Owned	50	31,068	30	22,971	(20)	(8,097)
Leased	7	2,643	6	2,245	(1)	(398)
Joint Venture	65	20,186	54	17,040	(11)	(3,146)
Managed	206	51,380	210	53,115	4	1,735
Franchised	1,900	249,391	2,054	275,350	154	25,959
Timeshare	31	3,740	34	3,948	3	208
TOTAL PROPERTIES	2,259	358,408	2,388	374,669	129	16,261

(1) Includes properties operated under our Conrad brand and properties operated under third party brands pursuant to contractual arrangements.

For purposes of the table above, owned properties are those in which we have a majority or controlling financial interest and joint venture properties are those in which we have a minority or non-controlling financial interest. For additional information, see Hotel Properties above.

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The following table sets forth certain system-wide information for our hotels with respect to occupancy rates, average room rates and revenue per available room (RevPAR) for the fiscal years ended December 31, 2004 and 2005:

	2004(1)	2005(1)	%/pt Change
Hilton			
Occupancy	69.6 %	71.7 %	2.1 pts
Average rate	$ 129.38	$ 140.42	8.5 %
RevPAR(2)	$ 90.06	$ 100.68	11.8 %
Hilton Garden Inn			
Occupancy	69.1 %	71.1 %	2.0 pts
Average rate	$ 98.65	$ 104.74	6.2 %
RevPAR(2)	$ 68.14	$ 74.47	9.3 %
Doubletree			
Occupancy	68.2 %	70.3 %	2.1 pts
Average rate	$ 102.29	$ 109.60	7.1 %
RevPAR(2)	$ 69.78	$ 77.01	10.4 %
Embassy Suites			
Occupancy	70.6 %	73.2 %	2.6 pts
Average rate	$ 123.30	$ 129.98	5.4 %
RevPAR(2)	$ 87.01	$ 95.09	9.3 %
Homewood Suites by Hilton			
Occupancy	73.5 %	75.6 %	2.1 pts
Average rate	$ 96.51	$ 100.57	4.2 %
RevPAR(2)	$ 70.93	$ 76.05	7.2 %
Hampton			
Occupancy	68.7 %	71.5 %	2.8 pts
Average rate	$ 81.57	$ 86.98	6.6 %
RevPAR(2)	$ 56.00	$ 62.22	11.1 %
Other(3)			
Occupancy	71.7 %	71.5 %	(0.2)pts
Average rate	$ 133.03	$ 148.80	11.9 %
RevPAR(2)	$ 95.33	$ 106.33	11.5 %

(1) Statistics are for comparable hotels, and include only those hotels in our system as of December 31, 2005 and owned, operated or franchised by us since January 1, 2004. Comparable hotels exclude our owned hotels in New Orleans due to the interruption in operations as a result of Hurricane Katrina.

(2) RevPAR is equal to rooms revenue divided by the number of available rooms.

(3) Includes properties operated under our Conrad brand and properties operated under third party brands pursuant to contractual arrangements.

For additional information regarding our hotel brands, see Hotel Brands above.

The following table sets forth certain system-wide statistical information for our hotels by geographic region as of and for the year ended December 31, 2005:

Regions	Properties	Rooms	Occupancy	Room Rate	RevPAR
Owned, Leased and Managed Hotels:					
Pacific/Mountain	87	31,844	74.7 %	$ 131.10	$ 97.98
North Central	36	11,862	70.7	129.89	91.84
South Central	57	14,947	68.5	109.51	75.03
New England/Middle Atlantic	32	12,494	80.5	206.18	165.95
South Atlantic	71	18,578	73.3	132.93	97.37
International	17	5,646	72.5	150.08	108.84
Total	300	95,371	73.8	141.12	104.14
Franchise Hotels	2,054	275,350	71.0 %	$ 99.59	$ 70.74

In the table above, statistics are for comparable hotels, and include only those hotels in our system as of December 31, 2005 and owned, operated or franchised by us since January 1, 2004. Comparable hotels exclude our owned hotels in New Orleans due to the interruption in operations as a result of Hurricane Katrina (see Note 19: Hurricane Katrina to the consolidated financial statements under Item 8). For additional information regarding our number of properties, number of available rooms and statistical information, see Supplementary Financial Information and Five Year Summary under Item 8.

ADDITIONAL INFORMATION

Casino Windsor

We own a 50% equity interest in Windsor Casino Limited, which operates the 400-room Casino Windsor in Windsor, Ontario, Canada for the Ontario provincial government under a management contract that expires in 2012. This hotel casino features a 75,000 square foot casino and entertainment and meeting facilities. See Additional Information Regulation and Licensing Ontario Gaming Laws below.

Design and Furnishing Services

Hilton Supply Management, our wholly owned subsidiary, provides design and furnishing services to our hotels and to hotels owned and operated by others. These services include the purchase and distribution of furniture, furnishings, equipment, food, beverage and operating supplies. The volume of this operation depends primarily on the number of new hotels we operate or franchise and on refurbishing and remodeling of our existing hotels.

Reservation System

Hilton Reservations Worldwide, LLC (HRW) oversees and operates a computerized, worldwide reservation system for hotels owned, operated or franchised by us, our affiliates and others. Prior to the HI Acquisition, Hilton and Hilton Group each owned a 50% interest in HRW. As a result of the HI Acquisition, HRW is now wholly owned by us. The domestic HRW reservation agents utilize an automated system that enables them to automatically cross-sell among all of our hotel brands which has benefited, and which we expect will continue to benefit, all of our hotel brands. See General Information Acquisition of Hilton International above.

HHonors

Hilton HHonors Worldwide, LLC (HHonors) is our guest loyalty program. Prior to the HI Acquisition, Hilton and Hilton Group each owned a 50% interest in HHonors. As a result of the HI Acquisition, HHonors is now wholly owned by us. HHonors includes the Hilton, Hilton Garden Inn, Doubletree, Embassy Suites, Homewood Suites by Hilton, Hampton and Conrad brands, as well as the Scandic and Coral by Hilton brands acquired in the HI Acquisition. Members of the HHonors program earn points based on their spending at most of the hotel properties operated and franchised by us and properties acquired in the HI Acquisition. HHonors accumulates and tracks points on the member s behalf and fulfills the awards upon request. Points can be redeemed for hotel stays at participating properties, and for a variety of other awards such as airline tickets, cruises and car rentals. We expect HHonors to continue to have a positive impact on our brands. See General Information Acquisition of Hilton International above and Note 2: Summary of Significant Accounting Policies to the consolidated financial statements under Item 8.

Technology and Distribution

We operate the Hilton worldwide internet website (www.hiltonworldwide.com) and our various hotel brand websites which provide cost effective customer service, including online hotel reservations and HHonors enrollment. We also provide various business, technology and information services for our hotel guests, including high speed internet access at virtually all of our hotels system-wide and self-service check-in kiosks at certain of our owned or managed hotels.

We operate our proprietary OnQ system, which is a single technology platform that links our brands and hotels to enhance customer service and loyalty, as well as maximize operational efficiencies. The OnQ system has been installed at virtually all of the hotels in our system as of December 31, 2005. As a result of the HI Acquisition, we intend to commence the installation of the OnQ system in the hotels we acquired. We also utilize an integrated strategy related to electronic and online distribution of rooms in our systems. The strategy provides for brand standards that permit each domestic hotel to establish its own room rates, but requires the hotel to offer such rates consistently across all designated distribution channels, including our proprietary websites, HRW call centers, Global Distribution Systems/travel agents, and through hotels directly. In addition, we have implemented enhancements to our major brand websites as part of the strategy.

Our Best Rates. Guaranteed. is our program which offers a price-matching guarantee that is designed to encourage customers to book their reservations through the above referenced distribution channels. We believe that this program, along with enhancements to our branded websites, has contributed to significantly increased numbers of transactions on our proprietary websites.

Trademarks

The following trademarks used herein are owned by us and are registered as trademarks in the United States and/or in certain foreign countries: Conrad®, Coral by Hilton®, Double Dip®, Double Dipping®, Doubletree®, Doubletree Club Hotel®, Doubletree Guest Suites®, Embassy Suites Hotels®, Embassy Vacation Resort®, Finn & Porter®, Hampton®, Hampton Inn®, Hampton Inn & Suites®, HGVClub®, Hilton®, HHonors®, Hilton Garden Inn®, Hilton Grand Vacations Club®, Hilton Hawaiian Village®, Homewood Suites by Hilton®, LivingWell®, Points & Miles®, Scandic®, Senior HHonors®, Waldorf=Astoria® and Waldorf=Astoria Collection . We consider all of these marks, and the associated name recognition, to be valuable to our business. See Note 2: Summary of Significant Accounting Policies to the consolidated financial statements under Item 8.

Marketing

Our hotel properties offer multiple product lines to a broad range of customers in many geographic markets. Our properties include full-service and limited service hotels in urban, airport, resort and suburban locations, as well as timeshare resorts.

Our metropolitan and airport properties primarily serve the convention and meeting market and the business traveler market (business persons traveling as individuals or in small groups). Our resort properties primarily serve the tour and leisure market (tourists traveling either as individuals or in groups) and the convention and meeting market. Our suburban properties primarily serve the leisure and business traveler markets. As indicated under Risk Factors under Item 1A below, these sources of business are sensitive to general economic and other conditions.

In 2005, we announced our sponsorship of the U.S. Olympic Team through 2008, which entitles our family of brands to use the official hotel sponsor designation and Olympic logo in advertising and marketing materials.

Forward-Looking Statements

Forward-looking statements in this report, including without limitation, those set forth under the captions Operations Development, Territorial Restrictions, Potential Acquisitions and Property Transactions and Additional Information Reservation System, HHonors, Competition, Environmental Matters and Regulation and Licensing, Properties, Legal Proceedings and Management s Discussion and Analysis of Financial Condition and Results of Operations, and statements relating to our plans, strategies, objectives, expectations, intentions and adequacy of resources, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words believes, anticipates, expects, intends, plans, estimates, projects, will, should, continues and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect our current views with respect to future events and financial performance and are subject to risks and uncertainties, including those identified under Risk Factors under Item 1A below and under Operations Development and Territorial Restrictions, Additional Information Marketing, Regulation and Licensing, and Management s Discussion and Analysis of Financial Condition and Results of Operations. Any of these risks and uncertainties could cause actual results to differ materially from historical results or those anticipated. We undertake no obligation to publicly update or revise any forward-looking statements to reflect current or future events or circumstances except as required by law.

Competition

We seek to maintain the quality of our lodging business while expanding both domestically and internationally, primarily through franchising and the addition of management contracts. We intend to improve our business by leveraging our strong brand names, maximizing operating efficiencies, utilizing cost containment programs, utilizing technology and expanding and enhancing properties. We may also acquire or develop properties as appropriate, either directly or through investments in joint ventures.

We believe that after the HI Acquisition, our position as a multi-branded owner, operator, manager and franchisor of hotels makes us the largest, by revenue, and most geographically diverse lodging company in the world. Competition in the industry is based primarily on the level of service, quality of accommodations, convenience of locations and room rates. Competition from other hotels, motels and inns, including facilities owned by local interests and facilities owned by national and international chains, is vigorous in all areas in which we operate or franchise our facilities. Our hotels also generally compete with facilities offering similar services in cities and other locations where our hotels are not present. If hotel capacity is expanded by others in a city where our branded hotels are located, competition will increase. Competition in the timeshare business is based primarily on the quality and location of timeshare resorts, the pricing of timeshare intervals and the availability of program benefits, such as exchange programs. We believe that our focus on core business strategies, combined with our financial strength, diverse market presence, strong brands and strategically located properties, will enable us to remain competitive. For additional information, see Risk Factors under Item 1A.

Environmental Matters

We, like others in our industry, are subject to various Federal, state, local and, in some cases, foreign laws, ordinances and regulations that:

(i) govern activities or operations that may have adverse environmental effects, such as discharges to air and water, as well as handling and disposal practices for solid and hazardous or toxic wastes; or

(ii) may impose liability for the costs of cleaning up, and certain damages resulting from, sites of past spills, disposals or other releases of hazardous or toxic substances or wastes (together, Environmental Laws).

Environmental Laws could make us liable for costs of removing or cleaning up hazardous or toxic substances on, under or in property we currently own or operate or that we previously owned or operated. Those laws could impose liability without regard to whether we knew of, or were responsible for, the presence of hazardous or toxic substances or waste. We endeavor to maintain compliance with Environmental Laws but, from time to time, our operations may have resulted or may result in noncompliance or liability for cleanup pursuant to Environmental Laws. In that regard, as of December 31, 2005, we had been notified of contamination resulting from past disposals of waste at six sites to which hazardous or non-hazardous waste may have been sent from our facilities in the past. Based on information reviewed by and available to us, including:

(i) uncertainty whether our facilities in fact shipped any waste to such sites;

(ii) the number of potentially responsible parties at such sites; and

(iii) where available, the volume and type of waste sent to such sites;

we believe that any liability arising from such disposals under Environmental Laws would not have a material adverse effect on our financial position or results of operations. However, there can be no assurance that this will be the case.

Regulation and Licensing

Ontario Gaming Laws. Ontario, Canada has laws and regulations governing the conduct of casino gaming. Ontario law requires that the operator of a casino must be found suitable and be registered. A registration once issued remains in force until revoked. Ontario law defines the grounds for registration, as well as revocation or suspension of such registration. The Ontario authorities have conducted an investigation of, and have found suitable, Hilton and the other shareholder of Windsor Casino Limited in connection with the Ontario registration of Windsor Casino Limited. See Additional Information Casino Windsor above.

Other Laws and Regulations. Each of the hotels and timeshare resorts we operate is subject to extensive state, local and national regulations and, on a periodic basis, must obtain various licenses and permits, including those required to sell alcoholic beverages. Federal and state laws and regulations also require certain registration, disclosure statements and other practices with respect to the franchising of hotels. As a result of the HI Acquisition, we are subject to the laws and regulations of approximately 80 countries. We believe that we have obtained all required licenses and permits and our businesses are conducted in substantial compliance with applicable laws.

Employees

At December 31, 2005, we employed approximately 61,000 team members, of whom approximately 18,000 were covered by various collective bargaining agreements providing, generally, for basic pay rates, working hours, other conditions of employment and orderly settlement of labor disputes. We believe that the aggregate compensation benefits and working conditions afforded our employees compare favorably with those received by employees in the hotel industry generally. See Risk Factors under Item 1A.

Available Information

Our internet website is located at www.hiltonworldwide.com. We make available free of charge through this website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our internet website also contains our Code of Business Conduct and Ethics for officers, employees and directors, including our Chief Executive Officer and senior finance officers (the Code of Ethics), our Corporate Governance Guidelines, Charters for our Audit, Compensation and Corporate Governance and Nominating Committees and information regarding stockholder communications with our Board of Directors. See hiltonworldwide.com, click on Investor Relations, then Corporate Governance. See also Item 10. Directors and Executive Officers of the Registrant. The information made available through our website is not incorporated by reference in this Form 10-K.

We will provide without charge to any person, on the written or oral request of such person, a copy of our annual report on Form 10-K, Code of Ethics, Corporate Governance Guidelines and Charters for our Audit, Compensation and Corporate Governance and Nominating Committees. Requests should be directed to our Corporate Secretary, Hilton Hotels Corporation, 9336 Civic Center Drive, Beverly Hills, California 90210 (telephone number (310) 278-4321).

Executive Officers of the Company

The following table sets forth certain information with respect to our executive officers.

Name	Positions with the Company	Age
Stephen F. Bollenbach	Co-Chairman of the Board and Chief Executive Officer since May 2004, and prior thereto, President and Chief Executive Officer	63
Matthew J. Hart	President and Chief Operating Officer since May 2004, and prior thereto, Executive Vice President and Chief Financial Officer	53
Ian R. Carter	Executive Vice President and Chief Executive Officer, Hilton International Co. (a subsidiary of Hilton Hotels Corporation) since March 2006, Chief Executive Officer, Hilton International Co. (a subsidiary of Hilton Group plc) from January 2005 until March 2006, and prior thereto, President Europe, Middle East and Asia Pacific, Black & Decker Corporation	44
Tim Harvey	Executive Vice President and Chief Information Officer since January 2006, and prior thereto, Senior Vice President and Chief Information Officer	47
Thomas L. Keltner	Executive Vice President and President Brand Performance and Development Group since March 2001, and prior thereto, Executive Vice President and President Franchise Hotel Group	59
Madeleine A. Kleiner	Executive Vice President and General Counsel, and Corporate Secretary since March 2001	54
Robert M. La Forgia	Executive Vice President and Chief Financial Officer since January 2006, Senior Vice President and Chief Financial Officer from May 2004 until January 2006, and prior thereto, Senior Vice President and Controller	47

Unless otherwise noted in the table, all positions and offices indicated have been continuously held since January 2001. The executive officers are responsible for all major policy making functions and all other corporate and divisional officers are responsible to, and are under the supervision of, the executive officers. None of the executive officers listed above are related.

Mr. Bollenbach also serves as a director of Hilton. Additional information for our directors will be included under Election of Directors in our definitive proxy statement to be used in connection with our annual meeting of stockholders scheduled to be held on May 24, 2006 (the Proxy Statement), and this information is incorporated in this Form 10-K. See Cover Page Documents Incorporated by Reference.

Item 1A. Risk Factors

We are subject to all of the operating risks common in the lodging and timeshare industries and our results may be adversely impacted if any of these risks materialize. Our results are significantly affected by occupancy and room rates achieved by our hotels, our ability to manage costs, our relative mix of owned, leased, managed and franchised hotels, supply and demand changes for hotel rooms and timeshare intervals in our markets, the quantity and pricing of timeshare interval sales and changes in the number of available hotel rooms and timeshare intervals through acquisition, development and disposition. Unfavorable changes in these factors as well as the occurrence of other events described below could negatively impact hotel room demand and pricing which, in turn, could limit our ability to pass through operating cost increases in the form of higher room rates. Our ability to manage costs could be adversely impacted by significant increases in operating expenses, such as wages and other labor costs, healthcare, insurance, property taxes and energy, as well as increases in construction costs, resulting in lower operating margins. In addition, economic factors beyond our control in the U.S. and internationally may create challenges for the lodging industry and us in 2006 and beyond. A downturn in economic conditions could impact the demand for hotel rooms and put pressure on room rates. Increases in transportation and fuel costs, the financial condition of the airline industry and its impact on air travel and sustained recessionary periods in the U.S. and internationally could also unfavorably impact future results.

Certain of our employees are covered by collective bargaining agreements and labor disputes may disrupt our operations. Employees at certain of our owned and managed hotels are covered by collective bargaining agreements that have either expired or will expire in 2006. These agreements affect a broad array of hotels in New York, San Francisco, Boston, Chicago, Honolulu, Pittsburgh, Los Angeles and Toronto. UNITE HERE, the union representing a majority of our unionized employees, has announced its intent to specifically target activities at Hilton properties and, in several key markets, exclude us from traditional multiemployer negotiations. We are preparing for the impact of potential labor activities, which may cause the diversion of business to other hotels, thereby impacting our results negatively. However, at this time, we cannot predict when or whether new agreements will be reached and what the impact of prolonged negotiations may be. Labor disputes in markets in which we have employees covered by collective bargaining agreements could disrupt our operations and adversely impact our financial results in these and other markets.

We derive a significant portion of our revenue from operations of our owned hotels and events in the markets where these properties are located could adversely affect our overall financial results. We derived approximately 46% of our revenue in 2005 from the operations of our owned hotels. A significant portion of these revenues derived from our large convention hotels located in major U.S. cities. See General Information Recent Developments and Operations Hotel Properties Owned Hotels above. In addition, we acquired 41 owned properties in the HI Acquisition. Soft economic conditions in any of the markets where our owned properties are located and reduced business travel could adversely affect our results from these properties and, therefore, our overall financial results. Our owned properties are also subject to risks that generally relate to investments in commercial real estate, including governmental regulations, real estate, insurance, zoning, tax and eminent domain laws, the ongoing need for capital improvements to maintain or upgrade properties, fluctuations in real estate values, and the relative illiquidity of real estate compared to other investments. If our owned properties do not generate sufficient revenue to meet operating expenses, including debt service and capital requirements, our financial results will be adversely affected.

We face challenges in integrating the operations of HI, as well as risks related to owning and operating real estate and hotels in international locations. We may not achieve expected synergies from the HI Acquisition, which include combining technology and distribution activities, consolidating regional infrastructure and integrating our Conrad brand into regional operations. We may also experience difficulties integrating the operations of HI, including integrating personnel with disparate business backgrounds and corporate cultures and managing relationships with hotel owners, lessors and other business partners on a worldwide basis. As a result of the HI Acquisition, we are subject to varying degrees of risk relating to international real estate generally, including risks related to changes in local, political, economic and market conditions, interest rates, zoning laws, currency exchange rate fluctuations, compliance with environmental laws, costs and terms of financing and the potential for uninsured casualty and other losses. A number of the leased properties we acquired in the HI Acquisition are subject to long-term contracts requiring fixed payments to the lessor. If these properties do not generate sufficient revenues, we may be required to fund shortfalls to the lessors which could adversely impact our financial results. In acquiring an ongoing business, we have succeeded to certain obligations and liabilities related to the business acquired in the HI Acquisition and have limited rights of indemnification with respect to such matters. As a result of the HI Acquisition, we are now subject to the laws and regulations of approximately 80 countries, which will expose us to risks relating to changes in franchise, tax, environmental, zoning, employment, repatriation of money, liquor license and other laws in the countries in which we operate. Some international jurisdictions restrict the repatriation of non-U.S. earnings. Various international jurisdictions also have laws limiting the ability of non-U.S. entities to pay dividends and remit earnings to affiliated companies unless specified conditions have been met. Sales in international jurisdictions typically are made in local currencies, which subject us to risks associated with currency fluctuations. Currency devaluations and unfavorable changes in international monetary and tax policies could have a material adverse effect on our profitability and financing plans, as could other changes in the international regulatory climate and international economic conditions. In addition, the U.S. government prohibits U.S. companies from operating in certain countries that are subject to economic sanctions or are on the terrorist countries list. We will not do business in such countries, unless we develop or acquire a non-U.S. affiliate that is capable of managing hotels or we get authorization from the U.S. Treasury Department s Office of Foreign Assets Control to do so. Some investors would be prohibited by state law or self-imposed policies from investing in our securities if we were to do business in such countries.

We are more highly leveraged as a result of the recent consummation of the HI Acquisition. If we are unable to make planned dispositions of certain of our owned hotels acquired in the HI Acquisition, it would impede our ability to reduce our indebtedness. We are currently marketing for sale certain owned hotel properties we acquired in the HI Acquisition. We are required to use the net proceeds from such dispositions to repay amounts outstanding under our credit facilities which were incurred to finance the HI Acquisition. If we are unable to complete such dispositions on commercially reasonable terms within anticipated timeframes, our ability to reduce our outstanding borrowings may be adversely affected, which could negatively impact our cost of borrowings, our financial results and our ability to raise new capital to finance future growth. Our senior debt ratings were recently downgraded to Ba2 by Moody s Investor Services and BB by Standard & Poor s Ratings Group subsequent to our announcement in December 2005 of our agreement to acquire the lodging assets of Hilton Group plc. A downgrade by any rating agency of the Company s credit rating adversely impacts the cost and availability of capital to us. Our higher level of debt and resulting interest expense may place us at a competitive disadvantage to competitors with lower amounts of indebtedness and/or higher credit ratings.

If we have disputes with the owners of hotels we manage, we could be subject to litigation. For our managed hotels, we have the responsibility to manage each hotel at a level consistent with the standard required for its brand in the relevant management agreement. Such provisions vary in scope and may be subject to differing interpretations. In the ordinary course of business, we encounter disagreements with the owners of our managed hotels as to whether the duties in our management agreements have been satisfied. To the extent that such conflicts arise, we seek to resolve them by negotiation with the relevant parties. In the event that such resolution cannot be achieved, litigation may result in damages or other remedies against us. Such remedies could include termination of the right to manage the relevant property. We may not be able to negotiate successfully or otherwise resolve such conflicts in each instance.

In competing for management, franchise and timeshare agreements and leases, we may make loans or provide guarantees to third parties and could experience losses under these loans or guarantee arrangements. The terms of our management, franchise and timeshare agreements and leases are influenced by contract terms offered by our competitors at the time such agreements are entered into. Accordingly, we may not enter into contracts or renew contracts in the future on terms that are as favorable to us as those under existing agreements. In connection with entering into these contracts, we may become obligated to make loans to or guarantee the obligations of third parties or guarantee minimum income to third parties. Weak performance, in particular as a result of a soft economy, could give rise to losses under these loans and guarantees. Changes in legislation or regulatory changes may be implemented that have the effect of favoring franchisees relative to brand owners.

The growth of internet reservation channels could harm our profitability. Some of our hotel rooms are booked through internet travel intermediaries. If these bookings increase, these intermediaries may be able to obtain higher commissions or other significant contract concessions from us. We believe that the aim of such intermediaries is to have consumers develop loyalties to their reservation systems rather than to our lodging brands. Although we expect most of our business to continue to be derived from traditional channels and our proprietary branded internet websites, if the amount of sales made through internet intermediaries increases significantly, our ability to control the supply, presentation and price of our room inventory and our profitability may be harmed.

We are a party to joint venture arrangements and investing through joint ventures decreases our ability to manage risk. We have from time to time invested, and expect to continue to invest, as a co-venturer. Joint venturers often have shared control over the operation of the joint venture assets. Therefore, joint venture investments may involve risks such as the possibility that the co-venturer in an investment might become bankrupt, or have economic or business interests or goals that are inconsistent with our business interests or goals, or be in a position to take action contrary to our instructions or requests or contrary to our policies or objectives. Consequently, actions by a co-venturer might subject hotels owned by the joint venture to additional risk. Additionally, we may be unable to take action without the approval of our joint venture partners, or our joint venture partners could take actions binding on the joint venture without our consent.

Our timeshare business is subject to extensive regulation and if we fail to comply with such regulation our timeshare business could suffer. We develop, manage, market and sell timeshare intervals, which generally entitle the buyer to occupy a fully-furnished unit for a one-week period on either an annual or an alternative-year basis. We also provide financing to purchasers of timeshare intervals. Certain of these activities are subject to extensive state regulation in both the state in which the property is located and the states in which the property is marketed and sold, as well as Federal regulation of certain marketing practices. In addition, the laws of most states in which we sell timeshare intervals grant the purchaser a unilateral right to rescind the purchase contract within a statutory rescission period. If we fail to be in compliance with applicable Federal, state, and local laws and regulations to which timeshare properties, marketing, sales and operations are subject, including Federal telemarketing regulations, or a determination by a regulatory authority that we were not in compliance, our timeshare business could suffer.

Our properties are subject to risks relating to acts of God, terrorist activity and war and any such event could materially adversely affect our operating results. Our financial and operating performance may be adversely affected by acts of God, such as natural disasters, particularly in locations where we own and/or operate significant properties. Some types of losses, such as those from earthquake, hurricane, terrorism and environmental hazards, may be either uninsurable or too expensive to justify insuring against. Should an uninsured loss or a loss in excess of insured limits occur, we could lose all or a portion of the capital we have invested in a property, as well as the anticipated future revenue from the property. In that event, we might nevertheless remain obligated for any mortgage debt or other financial obligations related to the property. Similarly, war (including the potential for war) and terrorist activity (including threats of terrorist activity), epidemics (such as SARs and bird flu), travel-related accidents, as well as geopolitical uncertainty and international conflict, which impact domestic and international travel, have caused in the past, and may cause in the future, our results to differ materially from anticipated results. Terrorism incidents such as the events of September 11, 2001 and wars such as the Iraq war in 2003 significantly impact international travel and consequently global demand for hotel rooms. In addition, inadequate preparedness, contingency planning or recovery capability in relation to a major incident or crisis may prevent operational continuity and consequently impact the value of the brand or the reputation of our business.

If we fail to comply with privacy regulations, we could be subject to fines or other restrictions on our business. We collect and maintain information relating to our guests for various business purposes, including maintaining guest preferences to enhance our customer service and for marketing and promotion purposes. The collection and use of personal data are governed by privacy laws and regulations enacted in the U.S. and other international jurisdictions in which we operate. Privacy regulation is an evolving area in which different jurisdictions may subject us to inconsistent compliance requirements. Compliance with applicable privacy regulations may increase our operating costs and/or adversely impact our ability to service our guests and market our products, properties and services to our guests. In addition, non-compliance with applicable privacy regulations by us (or in some circumstances non-compliance by third parties engaged by us) could result in fines or restrictions on our use or transfer of data.

We rely on our proprietary reservation systems and any failures in such systems could negatively affect our business. We invest in sophisticated technology and systems for property management, procurement, reservations, and the operation of our HHonors customer loyalty program. If our systems fail to operate as anticipated, or we fail to replace our systems with new systems introduced by our competitors, our business could suffer. In addition, we intend to combine the systems used by the hotels acquired in the HI Acquisition with ours, and if we experience difficulties in merging these systems, it could disrupt our operations.

In addition, see the cautionary factors set forth under Item 1 Business Additional Information Competition and Environmental Matters.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We consider our hotels to be leading establishments with respect to desirability of location, size, facilities, physical condition, quality and the variety of services offered in most of the areas in which they are located. Obsolescence arising from age and condition of facilities is a factor in the hotel industry. Accordingly, we spend, and intend to continue to spend, substantial funds to maintain the condition of our owned facilities in order to remain competitive.

Hotels and timeshare properties owned, leased, managed and franchised by us are briefly described under Item 1 and, in particular, under the caption Operations. In addition, new properties presently under construction that we will operate are briefly described under Operations Development under Item 1.

Item 3. Legal Proceedings

Incorporated by reference to the description of legal proceedings in Note 18: Commitments and Contingencies to the consolidated financial statements under Item 8.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our Common Stock is listed on the New York Stock Exchange and is traded under the symbol HLT. As of December 31, 2005, we had approximately 12,300 stockholders of record. The high and low reported sales prices per share of our Common Stock and dividends declared per share of Common Stock are set forth in the following table for the periods indicated:

	High	Low	Dividend Per Share
2004			
1st Quarter	$ 17.29	15.10	.02
2nd Quarter	18.70	16.29	.02
3rd Quarter	19.21	16.32	.02
4th Quarter	22.96	18.70	.02
2005			
1st Quarter	23.36	20.93	.02
2nd Quarter	25.06	21.37	.02
3rd Quarter	25.81	21.10	.04
4th Quarter	24.35	18.78	.04
2006			
1st Quarter (through March 10, 2006)	26.05	23.35	.04

Rights Agreement

On November 29, 1999, we adopted a preferred share purchase rights plan (the Rights Plan) and declared a dividend distribution of one preferred share purchase right (a Right) on each outstanding share of our Common Stock. The Rights Plan replaced our prior rights plan which had been originally adopted in 1988 and readopted in 1998 prior to its expiration. We have entered into a rights agreement, dated as of November 29, 1999, which was amended as of February 15, 2001 to provide for the substitution of The Bank of New York as Rights Agent (as amended, the Rights Agreement). The Rights are transferred only with the Common Stock, unless and until they become exercisable. The Rights will expire on November 29, 2009, subject to our right to extend, unless earlier redeemed or exchanged by us or terminated.

Generally, the Rights become exercisable only if a person or group (other than Hilton Interests, as defined below):

(i) acquires beneficial ownership of 20% or more of the Common Stock (such person or group, an Acquiring Person), or

(ii) announces a tender offer, the consummation of which would result in ownership by a person or group of 20% or more of the Common Stock.

When exercisable, each Right entitles a shareholder to purchase from us one one-hundredth of a share of Series A Junior Participating Preferred Stock at an exercise price of $80, subject to adjustment (the Purchase Price).

After a person becomes an Acquiring Person, each holder of a Right (other than Rights owned by the Acquiring Person) will have the right to receive, upon exercise of such Right, a number of shares of Common Stock having a market value equal to two times the then current Purchase Price of the Right. After a person becomes an Acquiring Person, if we engage in certain mergers or transfers of assets, each holder of a Right (other than Rights owned by the Acquiring Person) will have the right to receive upon exercise, at the Right s exercise price, a number of the acquiring company s common shares having a market value of twice the Right s Purchase Price.

Once a person becomes an Acquiring Person, but prior to their acquisition of 50% or more of the outstanding Common Stock, our Board of Directors may cause us to exchange the Rights (other than Rights owned by an Acquiring Person), in whole or in part, for shares of Common Stock at an exchange ratio based on the value of the Common Stock at that time, subject to adjustment.

Prior to a person or group becoming an Acquiring Person, the Rights are redeemable for $.001 per Right at the option of our Board of Directors.

Hilton Interests refer to Barron Hilton and the Conrad N. Hilton Fund and the shares of Common Stock beneficially owned by them.

The Rights Agreement, as amended, has been filed as Exhibits 4.8 and 4.9 to this Form 10-K, and the foregoing summary is qualified in its entirety by reference thereto.

Item 6. Selected Financial Data

The following selected financial data as of and for the years ended December 31, 2001 through 2005 has been derived from our consolidated financial statements. The following data should be read in conjunction with our consolidated financial statements, the related notes thereto contained under Item 8 and Management s Discussion and Analysis of Financial Condition and Results of Operations under Item 7.

	Year Ended December 31, 2001	**2002**	**2003**	**2004**	**2005**
	(in millions, except per share amounts)				
Results of Operations:					
Revenue	$ 3,952	3,816	3,819	4,146	4,437
Net income	166	198	164	238	460
Net income per share Basic	.45	.53	.43	.62	1.20
Net income per share Diluted	.45	.53	.43	.60	1.13
Other Financial Data:					
Dividends per common share	$ .08	.08	.08	.08	.12
Balance Sheet Data:					
Total assets	$ 8,785	8,348	8,183	8,242	8,743
Long-term debt	4,950	4,554	3,801	3,633	3,572

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are engaged in the ownership, management and development of hotels, resorts and timeshare properties and the franchising of lodging properties. At December 31, 2005, our system contained 2,388 properties totaling approximately 375,000 rooms, primarily in the United States. Our brands include Hilton, Hilton Garden Inn, Doubletree, Embassy Suites, Hampton, Homewood Suites by Hilton and Conrad. In addition, we develop and operate timeshare resorts through Hilton Grand Vacations Company and its related entities. In February 2006, we completed the acquisition of the lodging assets of Hilton Group plc for approximately £3.3 billion, equivalent to approximately $5.78 billion on the transaction date (see Note 20: Subsequent Events to the consolidated financial statements under Item 8). We are also engaged in various other activities related or incidental to the operation of hotels.

The number of properties and rooms at December 31, 2005 by brand and by type are as follows:

Brand	Properties	Rooms	Type	Properties	Rooms
Hilton	234	90,478	Owned(1)	30	22,971
Hilton Garden Inn	259	35,523	Leased	6	2,245
Doubletree	160	42,168	Joint Venture	54	17,040
Embassy Suites	182	44,429		90	42,256
Homewood Suites by Hilton	164	18,133	Managed	210	53,115
Hampton	1,336	134,121	Franchised	2,054	275,350
Other	19	5,869		2,264	328,465
Timeshare	34	3,948	Timeshare	34	3,948
Total	2,388	374,669	Total	2,388	374,669

(1) Includes majority owned and controlled hotels.

Our operations consist of three reportable segments which are based on similar products or services: Hotel Ownership, Managing and Franchising, and Timeshare. The Hotel Ownership segment derives earnings from owned, majority owned and leased hotel properties and equity earnings from unconsolidated affiliates (primarily hotel and other real estate joint ventures). The Managing and Franchising segment provides services including hotel management and licensing of our family of brands to franchisees. This segment generates its revenue from fees charged to hotel owners. As a manager of hotels, we are typically responsible for supervising or operating the hotel in exchange for fees based on a percentage of the hotel s gross revenue, operating profits, cash flow, or a combination thereof. We charge franchise fees, depending on the brand, of up to five percent of rooms revenue in exchange for the use of one of our brand names. The Timeshare segment consists of multi-unit timeshare resorts. This segment sells and finances timeshare intervals and operates timeshare resorts. The hospitality industry is seasonal in nature. However, the periods during which our properties experience higher or lower levels of demand may vary from property to property and depend principally upon location.

Our results are significantly affected by occupancy and room rates achieved by hotels, our ability to manage costs, the relative mix of owned, leased, managed and franchised hotels, the quantity and pricing of timeshare interval sales and the change in the number of available hotel rooms and timeshare intervals through acquisition, development and disposition. Results are also impacted by economic conditions and capacity. Unfavorable changes in these factors could negatively impact hotel room demand and pricing which, in turn, could limit our ability to pass through operating cost increases in the form of higher room rates. Additionally, our ability to manage costs could be adversely impacted by significant increases in operating expenses, resulting in lower operating margins. See Risk Factors under Item 1A for a description of these and other conditions that could adversely affect our results of operations.

We anticipate that a favorable economic environment will continue to benefit the lodging industry and our company in 2006. A continuation of strong hotel demand among business, group and leisure travelers, combined with limited full service hotel supply growth, should enable us to charge higher room rates. We also anticipate growth in our management and franchise fee business as the number of hotels in our system continues to increase, as well as strong results from our timeshare business. Increases in energy and healthcare costs combined with higher property taxes are expected to continue to put pressure on margins. Increases in construction costs could result in downward pressure on the margins achieved by our timeshare business. Our results could also be impacted by potential labor disputes involving the hotel industry and certain of our properties. We will continue to focus on managing our costs, achieving revenue per available room (RevPAR) premiums in the markets where we operate, increasing occupancy, adding new units to our family of brands, leveraging technology and delivering outstanding customer service. We believe that our focus on these core strategies, combined with our financial strength, diverse market presence, strong brands, and strategically located properties will enable us to remain competitive.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We evaluate our estimates and assumptions on an ongoing basis. We base our estimates and judgments on historical experience and other factors we believe to be reasonable under the circumstances, which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources.

We believe the following critical accounting policies, among others, affect our more significant estimates and assumptions used in preparing our consolidated financial statements. Actual results could differ from our estimates and assumptions.

Notes receivable are reflected net of an estimated allowance for uncollectible amounts. For timeshare notes receivable, this estimate is based primarily on historical experience and assumptions with respect to future payment trends. Allowances for uncollectible amounts of other notes receivable, which includes notes from managed, franchised and unconsolidated joint venture properties, are estimated based primarily on historical trends and analysis of underlying real estate collateral. Assessment of collateral may include estimates of future cash flow from the underlying real estate. Total notes receivable, including timeshare, totaled $350 million and $401 million, net of allowances for uncollectible amounts of $18 million and $24 million as of December 31, 2004 and 2005, respectively.

Property and equipment are stated at cost less accumulated depreciation. We also maintain cost and equity method investments in entities that own and operate hotel properties and entities that perform other activities related or incidental to the operation of hotels. The assessment of long-lived assets for possible impairment requires us to make certain judgments, including estimates of real estate values and future cash flow from the respective properties and investments. We review the recoverability of our long-lived assets when events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. Results in 2003, 2004 and 2005 include pre-tax impairment charges of approximately $4 million, $5 million and $5 million, respectively, to reduce the value of property and equipment and equity method investments to estimated fair value.

We account for the sale of real estate in accordance with Statement of Financial Accounting Standards (FAS) 66, Accounting for Sales of Real Estate. To the extent we realize gains from the sale of real estate and maintain significant continuing involvement in the form of a long-term management contract, the gain is deferred and recognized in earnings over the term of the contract. The deferral of pre-tax gains on such sales totaled $92 million, $5 million and $236 million in 2003, 2004 and 2005, respectively. Results in 2003, 2004 and 2005 include the recognition of pre-tax deferred gains totaling $10 million, $15 million and $23 million, respectively. The deferral of gain recognition is dependent on the structure of individual sale transactions.

Our intangible assets include management and franchise contracts, leases, brands and goodwill. We account for management and franchise contracts in accordance with FAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, which requires that we review our management and franchise contracts for impairment when circumstances indicate that their carrying amounts may not be recoverable. The values of our management and franchise contracts and leases are amortized using the straight-line method over the life of the agreements. The assessment of management and franchise contracts and leases requires us to make certain judgments, including estimates of future cash flow from the respective properties. Management and franchise contracts, net, totaled $336 million and $302 million at December 31, 2004 and 2005, respectively. We account for brands and goodwill in accordance with FAS 142, Goodwill and Other Intangible Assets, which requires that intangible assets with indefinite lives are not amortized, but are reviewed annually for impairment. The annual impairment review requires estimates of future cash flow with respect to the brands and estimates of the fair value of our company and its components with respect to goodwill.

We are self-insured for various levels of general liability, workers compensation and employee medical and dental insurance coverage at our owned locations. We purchase insurance coverage for claim amounts which exceed our self-insured retentions. Depending on the type of insurance, these self-insured retentions range from $250,000 to $500,000 per claim. The undiscounted amount of our self-insurance reserves totaled $148 million and $146 million at December 31, 2004 and 2005, respectively. Our insurance reserves are accrued based on estimates of the present value of claims expected to occur during the covered period. These estimates are prepared with the assistance of outside actuaries and consultants. Our actuaries periodically review the volume and amount of claims activity, and based upon their findings, we adjust our insurance reserves accordingly. The ultimate cost of claims for a covered period may differ from our original estimates. General liability and workers compensation claim estimates are discounted to determine the present value of projected settlements; the discount rates used in the 2003 through 2005 program years were approximately 3.0% to 4.25%, which we considered reasonable based on claims settlement patterns. Since medical and dental claims are generally paid within several months, we do not discount the related insurance reserves.

We have issued letters of credit and guaranteed certain debt and obligations of unconsolidated affiliates and third parties totaling $127 million at December 31, 2005. Under certain circumstances, we may be obligated to provide additional letters of credit or guarantees totaling $6 million. Assessment of the probability that we will be required to fund under these commitments requires us to make estimates of the ability of others to meet their obligations.

The estimates and assumptions related to notes receivable, long-lived assets, intangible assets, commitments and self-insurance reserves are subject to change based on the factors identified above. We believe our estimates and assumptions are reasonable and have resulted in accurate measurement of the related accounts in our historical financial statements in conformity with accounting principles generally accepted in the United States. Because estimates are used, it is reasonably likely that there will be some variability between projected results and actual results over time. In addition, given the significance of these accounts to our consolidated financial position, the variability between projected and actual results could be material to our financial position or results of operations.

DEVELOPMENT AND CAPITAL SPENDING

Overview

In February 2006, we completed the acquisition of the lodging assets of Hilton Group plc for approximately £3.3 billion, equivalent to approximately $5.78 billion on the transaction date. The all cash transaction was financed with existing cash on hand at the time of the closing and with borrowings under our new senior credit facilities (see Liquidity and Capital Resources Financing and Note 20: Subsequent Events to the consolidated financial statements under Item 8).

We also intend to grow our hotel system through franchising and the addition of management contracts, which require little or no capital investment. We will also continue to invest in capital improvements and select projects at our owned hotels and the development of timeshare properties. In addition, we may seek to acquire ownership interests in hotel properties on a strategic and selective basis, either directly or through investments in joint ventures.

During 2005, we added a total of 175 properties, primarily franchises, with approximately 25,000 rooms to our system. A total of 46 properties, primarily franchises, with approximately 8,000 rooms were removed from our system in 2005. We expect to add approximately 200 hotels and 28,000 rooms to our hotel system in 2006, with Hampton and Hilton Garden Inn accounting for most of the new development. We expect virtually all of this growth to be through franchise and management agreements. This growth excludes potential new international development opportunities as a result of the HI Acquisition.

We believe our brand growth strategy continues to benefit from the significant market share premiums most of our brands command over their respective competitive sets. With 100 representing a brand s fair share of the market, our brands (according to Smith Travel Research) posted revenue per available room (RevPAR) index numbers as follows for 2005: Embassy Suites, 119.7; Hampton, 118.1; Hilton Garden Inn, 112.5; Homewood Suites by Hilton, 111.8; Hilton, 108.8; and Doubletree, 97.3.

In July 2005, it was announced that Hampton, Hilton Garden Inn (for the fourth straight year) and Homewood Suites by Hilton (for the third straight year) each earned first place rankings for customer satisfaction in their respective categories from J.D. Power and Associates. Hilton was the only hotel company with three brands earning top rankings. In addition, the Hilton, Doubletree and Embassy Suites brands all improved their respective customer satisfaction scores in the 2005 J.D. Power study.

We believe the continued strong performance of our brands has enabled us to significantly enhance our development pipeline versus our industry competitors. We had approximately 600 hotels, primarily franchises, with 78,000 rooms in our development pipeline at December 31, 2005, excluding potential development associated with the HI Acquisition. The consummation of transactions in our development pipeline is subject to various conditions and uncertainties.

Our ability to grow the number of hotels in our system is affected by the factors referenced under Item 1A Risk Factors , such as international, national and regional economic conditions; the effects of actual and threatened terrorist attacks and international conflicts; acts of God, such as natural disasters; credit availability; relationships with franchisees and property owners; and competition from other hotel brands.

We will continue to review our owned hotel portfolio for potential repositioning or re-branding opportunities (see Liquidity and Capital Resources Acquisitions and Dispositions) and we may seek to sell certain assets, including assets acquired in the HI Acquisition (see Note 20: Subsequent Events to the consolidated financial statements under Item 8). It is our intention to be opportunistic when evaluating potential asset sales and we will look to sell particular hotel properties to the extent we can obtain premium prices. We are currently marketing for sale certain of our owned hotels. As discussed in Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8, until the necessary approvals have been received and substantive conditions to the buyer s obligation to perform have been satisfied, we do not consider a sale to be probable. When we sell a hotel property, it is generally our preference to retain a management or franchise agreement; however, we may sell hotels without retaining our brand.

Hotel Ownership

Capital expenditures during 2005, excluding timeshare projects, totaled $423 million. Excluding the $180 million to purchase land on Hawaii s Big Island, as discussed in Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8, our capital expenditures were $243 million, consisting primarily of routine improvements at our owned and leased hotels. We continue to place a priority on making appropriate capital expenditures to maintain and upgrade our owned assets. During 2005, we spent approximately $43 million to upgrade the bedding and televisions at our owned and leased hotels.

Managing and Franchising

Total property additions to our system in 2005 included 163 franchise properties and nine managed properties owned by third parties. These additions included 34 properties which, due in part to the market share leadership of our brands, were converted to our family of brands in 2005. The 34 conversions included 17 Doubletrees, seven Hiltons, four Hilton Garden Inns, two Hamptons, two Homewood Suites, one Embassy Suites and one Conrad.

In the first quarter of 2005, we announced an initiative with HI, formerly a wholly-owned subsidiary of Hilton Group plc, and now a wholly-owned subsidiary of ours (see Note 20: Subsequent Events to the consolidated financial statements under Item 8), to develop the luxury Conrad brand on a global basis. The growth in the Conrad brand will continue to be primarily through management agreements, including a new luxury property in Chicago (opened fourth quarter 2005), a new hotel in downtown Indianapolis (scheduled 2006 opening) and a new Conrad hotel on the Las Vegas Strip (scheduled 2008 opening). In the third quarter of 2005, Conrad announced the signing of a management contract for a 320-room luxury property in Jakarta, Indonesia, scheduled to open in 2008. We also hold a 10 percent investment in the partnership that is developing the Conrad Jakarta.

In early 2006, we introduced a new brand, the Waldorf=Astoria Collection. This new, elite brand designation debuts with New York s legendary Waldorf=Astoria, along with three world-class luxury resorts newly managed by Hilton: the Grand Wailea Resort Hotel & Spa on the island of Maui in Hawaii; the Arizona Biltmore Resort & Spa in Phoenix, and La Quinta Resort & Club in La Quinta, California. We anticipate that the Waldorf=Astoria Collection will grow primarily through branding of existing landmark or boutique hotels, co-branding of existing Hilton and Conrad hotels and opening newly built properties in select cities.

Timeshare

We are currently developing new timeshare projects in Las Vegas, Nevada, Orlando, Florida and Waikoloa, Hawaii. The Waikoloa project is expected to have 120 units, of which 22 units opened in 2005, with the remaining units scheduled for completion in spring 2006. At our International Drive property in Orlando (Tuscany Village), the project has 236 units open, representing four phases. Construction is continuing on the next 70 units, which are scheduled to open in spring 2006. Also in Orlando, we are adding 48 units to our existing property adjacent to Sea World. The second phase of our property on the Las Vegas Strip, which consists of 423 units, is on schedule for completion in summer 2006. Upon the opening of phase two, approximately 44% of the planned four-tower, 1,582-unit project will have been completed.

Capital expenditures associated with our timeshare operations during 2005 totaled $179 million. The capital expenditures associated with our non-lease timeshare products are reflected as inventory until the timeshare intervals are sold. We also provide financing to the buyers of our timeshare intervals. During 2005, we issued approximately $292 million of loans related to timeshare financings. Principal collections on timeshare notes during the same period were approximately $193 million.

LIQUIDITY AND CAPITAL RESOURCES

Overview

Net cash provided by operating activities totaled $380 million, $548 million and $486 million for the years ended December 31, 2003, 2004 and 2005, respectively. The net decrease in 2005 relates primarily to net cash used by timeshare construction in excess of timeshare sales and a reduction in deferred income taxes resulting from the sale of assets in 2005. These decreases were partially offset by improved operating results. The net increase in 2004 compared to 2003 was due primarily to improved operating results and net cash provided by timeshare sales in excess of new timeshare construction during the 2004 year. The increase in cash from operating activities also reflected timing differences resulting in an increased minimum pension liability and the deferral of revenue on timeshare sales. These increases were partially offset by increases in restricted cash and an increase in the net balance of timeshare notes receivable.

Net cash provided by operating activities in 2003, 2004 and 2005 each benefited from a reduction in the valuation allowance for capital loss tax carryforwards and other items which reduced the provision for income taxes (See Liquidity and Capital Resources Acquisitions and Dispositions and Note 12: Income Taxes to the consolidated financial statements under Item 8). Our ability to utilize capital loss tax carryforwards to reduce our provision for income taxes is dependent on the availability of capital loss tax carryforwards and the existence of transactions that enable these capital loss carryforwards to be utilized. Therefore, it should not be assumed that such benefits will be available to us in the future.

Net cash used in investing activities totaled $132 million in 2004 and net cash provided by investing activities totaled $620 million in 2005. The increase in net cash provided by investing activities was primarily due to an increase in net proceeds from asset dispositions in 2005 compared to the prior year, partially offset by higher capital expenditures. Net cash provided by investing activities totaled $60 million in 2003 compared to net cash used in investing activities of $132 million in 2004. The increase in net cash used in investing activities in 2004 was primarily due to reduced proceeds from asset dispositions in 2004 compared to 2003, as well as an increase in additional investments in 2004 over the prior year. This increase in net cash used was partially offset by higher payments received on non-timeshare notes receivable in 2004.

Net cash used in financing activities totaled $451 million, $122 million and $255 million in 2003, 2004 and 2005, respectively. The increase in 2005 reflects increased share repurchases and lower proceeds from the issuance of common stock, reflecting a lower volume of stock option exercises, partially offset by a lower level of debt repayments in the 2005 period. All amounts outstanding under our revolving credit facility were repaid in the second quarter of 2004. Net cash used in financing activities in 2003 and 2004 primarily represents the repayment of long-term debt in excess of additional long-term borrowings. The decrease in net cash used in financing activities in 2004 compared to 2003 reflects a lower level of debt repayment in the 2004 period once the revolving credit facility was repaid, and higher proceeds from the issuance of common stock in 2004, reflecting a higher volume of stock option exercises. This combined decrease in the net cash used in financing activities was partially offset by share repurchases in 2004.

Our ratio of earnings to fixed charges for the years ended December 31, 2003, 2004 and 2005 was 1.6x, 2.2x and 3.1x, respectively.

Cash and equivalents totaled $1.154 billion at December 31, 2005, an increase of $851 million from December 31, 2004. The increase in cash and equivalents is due primarily to the assets dispositions and increased operating results during 2005 over the previous year. In February 2006, we used approximately $850 million of cash to partially fund the purchase of the lodging assets of Hilton Group plc (see Note 20: Subsequent Events to the consolidated financial statements under Item 8 and Liquidity and Capital Resources Financing). Restricted cash totaled $182 million at December 31, 2005, an increase of $19 million from the prior year. Restricted cash includes cash related to certain consolidated hotels, the use of which is restricted for hotel purposes under the terms of collateralized borrowings; refundable deposits on the sale of timeshare intervals; and cash balances held by a consolidated non-controlled entity. We believe that our operating cash flow, available borrowings under our revolving credit facilities and our ability to obtain additional financing through various financial markets are sufficient to meet our liquidity needs (see Liquidity and Capital Resources Financing). However, any projections of future financial needs and sources of working capital are subject to uncertainty. See Results of Operations below, Additional Information Forward-Looking Statements under Item 1 and Risk Factors under Item 1A for further discussion of conditions that could adversely affect our estimates of future financial needs and sources of working capital.

Financing

At December 31, 2005, we had a $1 billion revolving credit facility, with an option to increase the size of the facility by an additional $250 million. This facility was amended in the first quarter of 2005. The amendment lowered our all-in cost of borrowing under this facility by 50 basis points from LIBOR plus 125 basis points to LIBOR plus 75 basis points and extended the facility until March 2010. There were no amounts outstanding under the revolving credit facility at December 31, 2005. The capacity under our revolver was also used to support certain outstanding letters of credit. Total revolving debt capacity of approximately $855 million was available to us at December 31, 2005.

In connection with the HI Acquisition in February 2006 (see Note 20: Subsequent Events to the consolidated financial statements under Item 8), we entered into new senior credit facilities in an aggregate principal U.S. dollar equivalent amount of approximately $5.75 billion with a syndicate of financial institutions. These facilities replaced our $1 billion revolving credit facility and are secured by a pledge of the capital stock of certain of our wholly-owned subsidiaries. The credit facilities consist of the following three tranches:

- U.S. Dollar Denominated Revolver 5 year, $3.25 billion available in U.S. dollars, British Pounds Sterling, Euros and Swedish Kronor or other currencies acceptable to the administrative agent. Interest at a variable rate depending upon our leverage ratio and senior debt ratings, with initial borrowings at LIBOR plus 150 basis points (which includes a 25 basis point annual facility fee).

- Foreign Currency Denominated Term Loan A 5 year, approximate equivalent of $2 billion to be denominated in £675 million, 675 million and Australian $140 million. Interest at a variable rate depending upon our leverage ratio and senior debt ratings, with initial borrowings at LIBOR plus 150 basis points.

- U.S. Dollar Denominated Term Loan B 7 year, $500 million term loan available only in U.S. dollars. Interest at a rate of LIBOR plus 137.5 basis points.

We also have the option to increase the credit facilities by $500 million.

In February 2006, we borrowed an aggregate principal U.S. dollar equivalent amount of approximately $4.8 billion under these facilities to partially fund the HI Acquisition.

Subsequent to our announcement in December 2005 of our agreement to acquire the lodging assets of Hilton Group plc, Standard & Poor s Ratings Group lowered our senior debt rating from BBB- to BB. In addition, Moody s Investor Services lowered our senior debt rating from Baa3 to Ba2. These downgrades are reflected in the interest rates and facility fee of our new $5.75 billion credit facilities. Under the terms of the credit facilities, the proceeds from the sale of certain owned properties acquired as part of the HI Acquisition are required to be used for the repayment of our senior credit facilities. In addition, we expect that excess cash flow will be used to repay outstanding debt balances to improve our credit position.

Provisions under various loan agreements require us to comply with certain covenants which include limiting the amount of our outstanding indebtedness. Our revolving credit facility at December 31, 2005, contained two significant financial covenants: a leverage ratio and a debt service coverage ratio. We were in compliance with our financial covenants as of December 31, 2005.

In October 1997, we filed a shelf registration statement with the Securities and Exchange Commission registering up to $2.5 billion in debt or equity securities. At December 31, 2005, available financing under the shelf totaled $825 million. The terms of any additional securities offered under the shelf will be determined by market conditions at the time of issuance.

Provisions of the financing agreement related to our 7.95% collateralized borrowings due 2010 require that certain cash reserves be maintained and also restrict the transfer of excess cash generated by the related properties from the subsidiary hotels to the parent company if net cash flow falls below a specified level (the cash trap). The cash trap became effective in 2003 due to reduced cash flow from the collateralized properties, primarily the Hilton San Francisco. As of December 31, 2005, cash restricted under the terms of the collateralized borrowings, including required reserves and the cash trap, totaled $146 million. The impact of the cash trap, which is expected to remain in effect throughout 2006, is not expected to have a material impact on our liquidity.

As of December 31, 2005, approximately 13% of our long-term debt, including the impact of interest rate swaps, was floating rate debt.

The following table summarizes our significant contractual obligations as of December 31, 2005, including long-term debt and operating lease commitments:

		Payments Due by Period			
Contractual Obligations (in millions)	**Total**	**Less than 1 year**	**1 3 years**	**4 5 years**	**After 5 years**
Long-term debt	$ 3,619	47	883	921	1,768
Operating leases	420	31	57	51	281
Total contractual obligations	$ 4,039	78	940	972	2,049

Total debt decreased by $28 million from December 31, 2004 to $3.619 billion at December 31, 2005. This decrease was primarily due to the repayment of two mortgages on one hotel sold during the 2005 second quarter. Operating lease commitments decreased by $289 million from December 31, 2004 to $420 million at December 31, 2005 primarily due to the purchase of land on which the Hilton Waikoloa Village is located (see Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8). We had previously leased this land pursuant to an agreement expiring in 2061. In addition, during the 2005 fourth quarter, we sold the Hilton San Diego which was subject to a long-term ground lease.

As a result of implementing FASB Interpretation Number (FIN) 46R Consolidation of Variable Interest Entities in 2004, our consolidated balance sheets as of December 31, 2004 and 2005 include the assets and liabilities of a non-controlled managed hotel, including $100 million of debt that is non-recourse to us. This amount is reflected on our consolidated balance sheet as non-recourse debt of non-controlled entity and is excluded from the contractual obligations table (see Note 4: Variable Interest Entities in the notes to the consolidated financial statements under Item 8).

Development Financing and Other Commercial Commitments

The following table summarizes our development financing and other commercial commitments as of December 31, 2005:

		Amount of Commitment Expiration Per Period			
Commercial Commitments (in millions)	**Total**	**Less than 1 year**	**1 3 years**	**4 5 years**	**After 5 years**
Letters of credit	$ 56	56			
Guarantees	71	57	10	2	2
Total commercial commitments	$ 127	113	10	2	2

See Note 18: Commitments and Contingencies to the consolidated financial statements under Item 8, for further discussion of our development financing and other commercial commitments.

Acquisitions and Dispositions

During 2005 we sold 20 owned or majority owned hotels, as well as our minority interests in several hotel joint ventures. In the second quarter of 2005, we completed two transactions involving the acquisition of land on Hawaii s Big Island for $180 million. See Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8, for further discussion of these transactions.

In February 2006, we completed the acquisition of the lodging assets of Hilton Group plc. See Note 20: Subsequent Events to the consolidated financial statements under Item 8 for further information.

Stockholders Equity

In the 2005 third quarter, our Board of Directors approved an increase to our common stock dividend of $.02 per share to $.04 per share. Annual dividends paid on common shares were $.08, $.08 and $.12 per share in 2003, 2004 and 2005, respectively.

During 2005, we repurchased approximately 12.3 million shares of our common stock at a total cost of approximately $271 million. The timing of stock purchases is made at the discretion of management. We did not repurchase any shares in the second half of 2005 because we were engaged in discussions with Hilton Group plc regarding a potential acquisition of their lodging business (see Note 20: Subsequent Events to the consolidated financial statements under Item 8). In 2004 we repurchased approximately 2.3 million shares of our common stock at a total cost of approximately $48 million. In March 2005, we announced that our Board of Directors authorized the repurchase of up to an additional 50 million shares of common stock. As of December 31, 2005, approximately 44.7 million shares remained authorized for repurchase under this authority.

OFF-BALANCE SHEET ARRANGEMENTS

We have outstanding guarantees issued in connection with our development financing programs and other guarantees of debt and other obligations of unconsolidated affiliates and third parties, as well as commitments under letters of credit. See Note 18: Commitments and Contingencies to the consolidated financial statements under Item 8, for more information. We maintain investments in unconsolidated affiliates, including hotel joint ventures as well as other entities that support the operations of our hotel properties. We do not have investments in or obligations with respect to unconsolidated special purpose entities and we have not entered into synthetic leasing arrangements.

RESULTS OF OPERATIONS

The following discussion presents an analysis of our results of operations for the three years ended December 31, 2005. Our operations consist of three reportable segments which are based on similar products or services: Hotel Ownership, Managing and Franchising, and Timeshare.

FISCAL 2005 COMPARED WITH FISCAL 2004

Overview

A summary of our consolidated results for the years ended December 31, 2004 and 2005 is as follows:

	2004	2005	% Change
	(in millions, except per share amounts)		
Revenue	$ 4,146	4,437	7 %
Operating income	658	805	22
Net income	238	460	93
Basic EPS	.62	1.20	94
Diluted EPS	.60	1.13	88

Results in 2005 benefited from strong increases in room nights and average daily rate (ADR) across all business segments, with particularly strong increases in ADR, resulting in double-digit RevPAR growth and margin improvement at many of our comparable owned hotels. Management and franchise fee revenue was our highest to date, increasing 18 percent over the prior year as a result of RevPAR growth and the addition of new units. Results in 2005 also benefited from strong results at our timeshare business. Net income in 2005 also benefited from gains associated with the sale of owned hotels and a reduction in the provision for income taxes. Revenue growth was adversely impacted by the aforementioned asset sales and the impact of Hurricane Katrina on our two owned hotels in New Orleans.

Revenue from owned hotels totaled $2.049 billion in 2005, a one percent decrease from $2.062 billion in 2004, and total expenses in 2005 were down three percent to $1.459 billion. Strong results at our comparable owned hotels were partially offset by the impact of asset sales and Hurricane Katrina. Our two owned hotels in New Orleans are excluded from the comparable numbers due to interruptions in operations caused by the hurricane. See Note 19: Hurricane Katrina to the consolidated financial statements under Item 8. Excluding the impact of assets sales and our two owned hotels in New Orleans, owned hotel revenue in 2005 was up 10 percent to $1.670 billion from $1.519 billion in 2004, while owned hotel expenses increased seven percent to $1.190 billion from $1.109 billion in 2004.

Results at our comparable owned properties benefited from continued strong demand and average rate increases from groups, business and leisure travelers, including double-digit rate and RevPAR increases from the leisure and business segments. Results in New York and Hawaii were particularly strong in 2005. Strong results were also reported at our owned hotels in Boston, Washington D.C. and Atlanta, while San Francisco remained comparably weak. RevPAR for comparable owned properties increased 11.9 percent for the year, with occupancy rising 2.2 points to 77.3 percent and average daily rate up 8.7 percent to $178.35. Approximately 75 percent of the RevPAR increase at the comparable owned hotels was attributable to rate gains.

While strong RevPAR increases led to solid growth in rooms revenue, other comparable owned hotel revenue also performed well, with food and beverage revenue increasing seven percent over 2004. Group room nights, which typically generate higher margin food and beverage business, were up two percent at our comparable owned hotels. Margins at our comparable owned hotels (revenue less expenses as a percentage of revenue for comparable owned hotels) improved 180 basis points in 2005 to 28.8 percent. Cost-per-occupied-room increased 4.5 percent in 2005, reflecting a 17 percent increase in energy costs.

Leased hotel revenue totaled $111 million in 2005, consistent with 2004, while leased hotel expenses decreased two percent to $99 million. Due to the relatively large size of the lease payments required in a hotel operating lease, the leased properties operate at margins significantly lower than our owned hotels. Leased hotel revenue and expenses are included with our owned hotels in our Hotel Ownership segment results.

Operating income from unconsolidated affiliates decreased $5 million in 2005 to $44 million. The decrease relates primarily to a $10 million pre-tax gain in the 2004 period, resulting from a joint venture that developed a condominium project in Myrtle Beach, South Carolina. This decrease was partially offset by improved results at joint venture properties and the termination or sale of certain joint venture interests that generated losses in 2004. Operating income from unconsolidated affiliates is included in our Hotel Ownership segment results.

Management and franchise fee revenue increased $68 million or 18 percent to a record $452 million in 2005. Fee revenue is based primarily on rooms revenue at franchise properties and total operating revenue (and to a lesser extent gross operating profits or cash flow) at managed properties. The strong demand among business, groups and leisure travelers that benefited our owned hotels also resulted in strong RevPAR gains for each of our brands on a system-wide basis (including managed and franchised properties). The increase in management and franchise fees in 2005 also reflects the addition of new units to our system of hotels.

Revenue from our timeshare operations (included in timeshare and other income) totaled $554 million, an increase of $133 million or 32 percent from $421 million in 2004. Timeshare expenses in 2005 (included in other operating expenses) were $420 million compared to $316 million in the prior year. Timeshare revenue and earnings are generated through developing timeshare resorts and selling the related intervals, financing the sale of timeshare intervals and through management of timeshare resorts. Overall timeshare unit sales were up eight percent in 2005, reflecting continued strong sales at our projects in Hawaii, Las Vegas and Orlando. The average unit sales price increased two percent across the system. Timeshare revenue and profitability also benefited from higher resort fees and higher financing income due to increased sales. Timeshare results in 2005 also reflect the recognition of previously deferred revenue and expenses at our Waikoloa project, due to the required percentage-of-completion accounting. Construction at the Waikoloa project was approximately 75 percent complete at the end of 2005. In contrast, construction was not beyond a preliminary stage at the end of 2004.

Depreciation and amortization expense decreased $31 million in 2005 to $299 million, primarily due to asset sales and lower amortization expense related to certain long-term management and franchise agreements that were either terminated or expired.

Results in 2005 include impairment loss and related costs totaling $7 million, which includes a pre-tax charge of $2 million related to an owned hotel and a $3 million pre-tax charge related to our minority interests in eight joint venture hotels to reduce their respective carrying values to their estimated fair values. The 2005 charge also includes a $2 million pre-tax charge representing the write down of a non-hotel cost basis investment to its estimated fair value. The $5 million impairment charge is included in our Hotel Ownership segment results, while the $2 million charge on the non-hotel investment is not allocated among our reportable segments. Results in 2004 include impairment loss and related costs totaling $5 million. This pre-tax charge was to reduce the value of an owned hotel to its estimated fair value and is included in Hotel Ownership segment results.

Corporate Activity

Corporate expense totaled $103 million in 2005, an increase of $18 million from 2004. The increase is primarily the result of increased expense associated with stock-based compensation, increased hotel team member performance awards and contributions to Hurricane Katrina relief efforts. Corporate expense is not allocated among our reportable business segments.

Interest and dividend income increased $6 million compared to the prior year. This increase reflects an increase in cash management activities, reflecting higher cash balances in 2005 due primarily to proceeds from asset sales. This increase was partially offset by lower interest income due to the repayment by Caesars Entertainment, Inc. of the $325 million 7% Senior Notes in July 2004. Interest on the notes is reflected as both interest income and interest expense in our consolidated statements of income through repayment in July 2004. Interest expense, net of amounts capitalized, decreased $15 million compared to 2004, due primarily to the aforementioned repayment by Caesars.

The $103 million gain on asset dispositions and other in 2005 includes gains from asset sales of $112 million (see Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8), a $10 million loss on our foreign currency options (see Note 2: Summary of Significant Accounting Policies Derivative Instruments to the consolidated financial statements under Item 8) based on the market value of the options at December 31, 2005, and a $3 million gain on our oil futures derivative (see Note 2: Summary of Significant Accounting Policies Derivative Instruments to the consolidated financial statements under Item 8) based on the market value of the contract at December 31, 2005. Also included in 2005 is a net loss of $1 million related to the write-off of several long-term management and franchise agreements which were terminated during the year and a $1 million loss on the disposition of other fixed assets. The $5 million pre-tax loss on asset dispositions and other in 2004 represents the sale of two Doubletree properties, the write off of the value assigned to several long-term management and franchise agreements which were terminated during the year and a loss due to the fair market value adjustment of our derivative instruments, partially offset by the gain from the sale of certain investments.

The loss from non-operating affiliates of $6 million and $17 million in 2004 and 2005, respectively, represents equity losses associated with our 24 percent minority interest in a coal-based synthetic fuel facility. The synthetic fuel produced at this facility qualifies for tax credits based on Section 29 of the Internal Revenue Code; these credits reduce our provision for income taxes (see Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8). We acquired our minority interest in August 2004, which results in the comparably low amount in the prior year.

The effective income tax rate for 2005 decreased to 26% from 34% in 2004. The effective rate in 2005 includes a benefit of $28 million resulting from closures of IRS audits, a reduction in the valuation allowance for capital loss tax carryforwards totaling $34 million associated with asset sales and the utilization of Section 29 synthetic fuel production credits of approximately $17 million. The 2005 effective tax rate also includes net state tax credits of approximately $2 million. The effective tax rate in 2004 benefited from a reduction in the valuation allowance for capital loss tax carryforwards of approximately $7 million resulting from the sale of three Doubletree properties (La Posada in Arizona, as well as Bakersfield and Modesto in California) and the sale of our interest in Travelweb. In addition, the 2004 effective tax rate also reflects the utilization of Section 29 synthetic fuel production credits of approximately $7 million. Excluding the aforementioned items, our effective rate was 39% in 2005 and 38% in 2004. Our effective tax rate is determined by the level and composition of pre-tax income and the mix of income subject to varying foreign, state and local taxes.

Minority and non-controlled interests expense, net, increased $4 million to $12 million in 2005, reflecting a distribution to our minority partner on the sale of the Hilton Glendale (see Note 3: Acquisitions and Dispositions to the consolidated financial statements under Item 8).

Hotel Statistics

RevPAR for U.S. owned hotels and system-wide for the years ended December 31, 2004 and 2005 is as follows:

	U.S. owned(1) 2004	2005	% Change
Hilton	$ 128.32	144.00	12.2 %
All other	84.58	91.45	8.1
Total	123.24	137.90	11.9

(1) Statistics are for comparable U.S. hotels, and include only hotels in the system as of December 31, 2005 and owned by us since January 1, 2004. Comparable hotels exclude our owned hotels in New Orleans due to the interruptions in operations as a result of Hurricane Katrina.

	System-wide(2) 2004	2005	% Change
Hilton	$ 90.06	100.68	11.8 %
Hilton Garden Inn	68.14	74.47	9.3
Doubletree	69.78	77.01	10.4
Embassy Suites	87.01	95.09	9.3
Homewood Suites by Hilton	70.93	76.05	7.2
Hampton	56.00	62.22	11.1
Other	95.33	106.33	11.5

(2) Statistics are for comparable hotels, and include only hotels in the system as of December 31, 2005 and owned, operated or franchised by us since January 1, 2004. Comparable hotels exclude our owned hotels in New Orleans due to the interruptions in operations as a result of Hurricane Katrina.

FISCAL 2004 COMPARED WITH FISCAL 2003

Overview

A summary of our consolidated results for the years ended December 31, 2003 and 2004 is as follows:

	2003	2004	% Change
	(in millions, except per share amounts)		
Revenue	$ 3,819	4,146	9 %
Operating income	515	658	28
Net income	164	238	45
Basic EPS	.43	.62	44
Diluted EPS	.43	.60	40

Results in 2004 benefited from RevPAR growth at our comparable owned hotels due to increased demand from both business travelers and group business, combined with continued strong demand from leisure travelers. This shift in the mix of business to higher rated room nights from business travelers and groups resulted in increased pricing power in 2004. Fee income increased in 2004 as a result of RevPAR growth at managed and franchised hotels and the addition of new units. Results in 2004 also benefited from strong results at our timeshare business and lower interest expense. Overall results in 2003 were adversely impacted by business declines related to the conflict in Iraq and a soft U.S. economy. In addition, 2003 was negatively impacted by a pre-tax impairment charge totaling $22 million and cost increases at our owned hotels.

Results in 2004 also reflect the implementation of FIN 46R, which resulted in the consolidation of a previously unconsolidated managed hotel, effective January 1, 2004. The implementation of FIN 46R resulted in an increase in other revenue and expenses from managed and franchised properties and certain other expenses in 2004. However, it had no impact on reported net income or net income per share.

Revenue from owned hotels totaled $2.062 billion in 2004, a two percent increase from $2.031 billion in 2003, and total expenses in 2004 were flat with 2003 at $1.501 billion. Strong results at our comparable owned hotels were partially offset by the impact of asset sales. Excluding the impact of assets sales, owned hotel revenue increased seven percent from $1.893 billion in 2003 to $2.026 billion in 2004, while owned hotel expenses increased five percent from $1.398 billion in 2003 to $1.473 billion in 2004.

Results at our comparable owned properties improved compared to 2003 due to business and group travel gains, combined with strong leisure demand. The more favorable mix of business helped drive an increase in average rate, particularly in the latter half of the year. The strong group business also led to an increase in food and beverage profits in 2004. Results at our owned hotels in 2004 also benefited from our continued focus on costs. Cost-per-occupied-room increased less than one percent in 2004. Profitability at our owned hotels in 2003 was negatively impacted by the aforementioned soft U.S. economy and reduced travel as a result of the conflict in Iraq, along with increased healthcare, insurance and property tax costs. Margins at our comparable owned hotels improved 110 basis points compared to the prior year.

RevPAR for comparable owned properties increased 6.8 percent for the year, with occupancy rising 2.6 points to 73.3 percent and average daily rate up 3.1 percent to $153.72. Our owned properties in Boston, New York and Hawaii achieved particularly strong results in 2004. As anticipated, our owned properties in downtown Chicago posted weaker results compared to 2003 due to a reduction in the number of citywide conventions in this market. Excluding the impact of Chicago from both periods, RevPAR for comparable owned properties increased 8.2 percent in 2004.

Leased hotel revenue totaled $111 million in 2004, an eight percent increase compared to 2003, while leased hotel expenses increased five percent to $101 million. Operating income from unconsolidated affiliates increased $15 million in 2004 to $49 million. The increase is primarily the result of $10 million in pre-tax earnings from a joint venture that developed a 251-unit condominium project in Myrtle Beach, South Carolina. The project closed on the sale of all units in the third quarter of 2004. Operating income from unconsolidated affiliates also benefited from improved results at our joint venture hotel properties.

Management and franchise fee revenue in 2004 increased $47 million or 14 percent to $384 million. The strong demand among business, groups and leisure travelers that benefited our owned hotels also resulted in strong RevPAR gains for each of our brands on a system-wide basis (including managed and franchised properties). The increase in management and franchise fees in 2004 also reflects the addition of new units to our system of hotels.

Revenue from our timeshare operations totaled $421 million, an increase of $76 million from $345 million in 2003, while timeshare expenses in 2004 totaled $316 million, an increase of $57 million from $259 million in the prior year. Overall timeshare unit sales were up 35 percent in 2004, with robust sales at our projects in Hawaii, Las Vegas and Orlando. The average unit price increased five percent across the system. Timeshare revenue and profitability also benefited from higher resort fees and higher financing income due to increased sales. The growth from increased sales volume and price were partially offset by unfavorable deferrals compared to the 2003 period, due to the required percentage-of-completion accounting. Results in 2004 were negatively impacted by the deferral of revenue and expenses at our Waikoloa project, as construction was not beyond a preliminary stage. In contrast, results in 2003 benefited from the recognition of previously deferred r