

1998 annual report



On the cover:

A new company... a new look. Hilton Hotels Corporation and Hilton International have introduced a single, unified logo to present to the world's travelers.

2
Financial Highlights

3
Year in Review

4
Letter to Shareholders

8
Capitalize on Our
Strong Owned Hotels

12
Acquire Full-Service Hotels

15
Grow Our Brand

16
Financial Overview

17
Financial Information

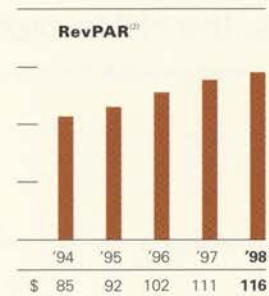
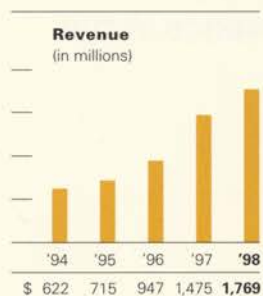
40
Board of Directors,
Officers and Corporate
Information

the **n**ame that embodies the
very essence of lodging hospitality

Hilton Hotels Corporation is recognized internationally as a preeminent hospitality company. Among our 250 hotels are some of the most well-known properties to be found anywhere, including The Waldorf=Astoria, Hilton Hawaiian Village and Palmer House Hilton. Our hotels offer guests and customers the finest accommodations and amenities for business or leisure. For 80 years, the Hilton brand name has been synonymous with excellence in the hospitality industry.

financial highlights

(in millions, except per share amounts)	1997	1998	Percent Change
Revenue	\$1,475	1,769	20%
EBITDA ⁽¹⁾	497	596	20
Operating income	395	464	17
Income from continuing operations	183	188	3
Income from continuing operations per share — diluted	.68	.71	4



⁽¹⁾ EBITDA is earnings before interest, taxes, depreciation, amortization and non-cash items. Non-cash items, such as asset write-downs and impairment losses, are excluded from EBITDA as these items do not impact operating results on a recurring basis. This information should not be considered as an alternative to any measure of performance as promulgated under generally accepted accounting principles (such as operating income or net income), nor should it be considered as an indicator of the overall financial performance of the Company. The Company's calculation of EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

⁽²⁾ Comparable domestic owned and managed properties.

2010 year in review

JANUARY

- Hilton acquires 458-room Hilton McLean Tyson's Corner in the metropolitan Washington D.C. area
- Hilton Garden Inn Lake Mary opens in Florida
- New franchise properties added: Hilton Mexico City Airport; Hilton Seelbach in Louisville, Kentucky

MARCH

- 1 Company purchases 5-Diamond, 300-room Hilton at Short Hills in New Jersey
- Hilton Garden Inn Atlanta Windward opens in Georgia

APRIL

- 2 Company acquires two full-service hotels: Hilton Charlotte (formerly the Westin) in North Carolina and the Hilton DFW Lakes Executive Conference Center in Dallas (pictured)
- Hilton Garden Inns open at Albany Airport in New York and Raleigh Durham Airport in North Carolina

MAY

- New franchise property added: 204-room Hilton Monterey in California

JUNE

- Hilton agrees to acquire additional 48% interest in the Hilton Hawaiian Village in Honolulu
- Company announces plans to spin-off gaming operations to shareholders in a tax-free distribution

- 3 Dieter Huckestein, president — hotel operations, celebrates launch of new global brand identity with corporate staff members
- New franchise properties added: Hilton Clearwater Beach Resort in Florida; Hilton Tulsa Southern Hills; Hilton Guadalajara

1



2



3



4



5



JULY

- Hilton purchases 405-room Hilton East Brunswick & Towers in New Jersey

AUGUST

- 4 "Topping-off" of the new 600-room Hilton Boston Logan Airport
- Company acquires 585-room Pointe Hilton Tapatio Cliffs Resort in Phoenix

- 5 Groundbreaking for new 232-suite vacation ownership property adjacent to the Las Vegas Hilton

OCTOBER

- Hilton Garden Inns open in Cupertino, California and Seattle, Washington
- New franchise property added: Hilton Jackson Conference Center in Mississippi

NOVEMBER

- Hilton Garden Inns open in Chihuahua, Mexico and Albuquerque, New Mexico

DECEMBER

- Spin-off of gaming operations to shareholders completed.
- Company acquires 394-room Hilton La Jolla Torrey Pines (formerly the Sheraton Grande) in California
- New franchise property added: Hilton Hartford in Connecticut

dear fellow shareholders:

With the distribution on December 31, 1998 of our casino gaming business, Hilton Hotels Corporation embarks on a new era as a dedicated hotel company, utilizing our rich history, world renowned brand name, first-rate portfolio of owned hotels, aggressive acquisition strategy, strong balance sheet and focused management team to strengthen our leadership position in the lodging industry.

Our decision last year to separate our two businesses created yet another worldwide industry leader — Park Place Entertainment Corporation. Through its merger with the Mississippi operations of Grand Casinos, Inc., and its unassailable positions in Nevada, New Jersey and other gaming jurisdictions, Park Place has emerged as the world's largest and most diversified casino gaming company. We look forward to Park Place's growth and success.

As we look to the future of Hilton Hotels Corporation, we find excellent opportunities to build value for our shareholders. Our blueprint for value creation going forward is not unlike that which we have employed successfully to double the size of our lodging business, achieve significant hotel EBITDA gains and broaden the presence of our brand over the last three years. Our growth in 1999 will be achieved through this series of solid and very achievable strategies:

Capitalize on the strength of our owned full-service hotels.

Our portfolio of owned hotel real estate is second to none in our industry. The Waldorf=Astoria, Hilton New York, Hilton La Jolla Torrey Pines, Hilton Chicago, Hilton San Francisco, Hilton Hawaiian Village, Hilton Short Hills and many of our other great properties are fabulous, irreplaceable assets in bulls-eye locations in major markets.

These hotels are extremely well-positioned to show strong profit growth over the next several years. Contributing to our optimism is a continuing shortage of first-class, full-service hotel rooms in most of the key markets where we generate the bulk of our cash flow and earnings.

Much was said and written during 1998 about so-called "new supply" in the hotel industry, reports that understandably had an adverse impact on the stocks of most of the large-cap lodging companies... including ours. In fact, however, most of this research failed to make the important points that: 1) the lion's share of the new supply is in market categories (e.g. mid-priced, extended stay) that pose no competitive threat to our large, city-center, full-service owned hotels; and 2) any new construction there is, is centered primarily in cities where we currently have little, if any, ownership presence.

With the exception of Chicago — where new full-service supply will be balanced by increased capacity at McCormick Place and the strength of the city's economy — new competitive supply is virtually non-existent in our important markets: New York, San Francisco, Honolulu, New Orleans and Washington, D.C. More to the point, given the long financing, entitlement, development and construction lead times, it is unlikely that this scenario will change appreciably over the next few years. Underscoring this point is the fact that many lodging companies which had announced grandiose development plans in 1998 have (wisely!) put those plans on indefinite hold.

On the demand side of the equation, the majority of these cities remain vibrant destinations for both business and leisure travel... just ask anyone who has tried to book a room during the week at an upscale hotel in midtown Manhattan or San Francisco's Union Square! While Hawaii continued to be a sluggish market in 1998 due to the economic situation in Asia — and will remain so in 1999 — we look for a rebound beginning in 2000.

The continuing favorable supply environment, a strong economy, our ongoing efforts to improve operating margins (which are already among the highest in the industry,) our well-maintained and well-located properties, and a management team focused on providing excellent customer service, give us great confidence in our ability to show strong revenue per available room (RevPAR) and EBITDA gains going forward. RevPAR and EBITDA at our comparable U.S. owned hotels increased 4.8 percent and 11 percent, respectively, in 1998, and we believe it is both realistic and attainable in 1999 to achieve a four to five percent RevPAR increase at these properties, translating to a very solid same-store EBITDA growth rate of eight to ten percent.

Continue acquiring attractive full-service hotels at discounts to replacement cost.

Building on the strength of our existing portfolio of owned hotel properties, a primary growth initiative in 1999 will be a continuation of our aggressive acquisition of full-service hotels at discounts to replacement cost in markets with high barriers to entry.

Our three-year acquisition program has resulted in the purchase of nearly \$1.5 billion of high quality assets... \$1 billion alone in 1998 and early 1999. Last year's acquisitions included properties in such vibrant and strategic markets as Charlotte, San Diego, Dallas, Honolulu, Phoenix and the New York and Washington, D.C. metropolitan areas.

The environment for purchasing properties at attractive multiples of cash flow is exceptionally favorable for Hilton. Importantly, those with the wherewithal to compete with us for good hotel assets are becoming fewer and farther between. The real estate investment trusts generally lack the resources now to aggressively acquire hotels. The markets are becoming increasingly constrained for less well-capitalized buyers who represent our competition when we pursue the acquisition of a particular hotel. And with the continuing economic turmoil in Asia, we should see a significant number of Japanese-owned properties come to market.

We responded assertively to this positive environment in 1998, and given the favorable outlook for 1999, maintain our commitment to be a proactive acquirer of full-service hotels at attractive prices.

Our commitment to you is to continually evaluate the best and most effective uses of our capital resources. While a cornerstone of our growth strategy is using this capacity to acquire hotel properties, we always watch closely over our stock price; buying back our stock remains an option if that should represent an especially attractive return on investment for our shareholders.

Broaden the Hilton brand name.

The powerful Hilton brand name, synonymous around the world with quality lodging hospitality, is perhaps our most precious asset. Strengthening and expanding the brand continues to be among our most important goals.

An aggressive North American franchising effort, bringing Hilton-style quality to increasing numbers of cities and customers, should also deliver the benefit of growing our franchise fee income by more than 50 percent by the end of 2001. This effort has been highlighted by our successful Hilton Garden Inn program. We are on target to reach our goal of having 200 of these well-designed, mid-priced hotels open or under construction by the end of 2000. Our franchisees expect to open 65 more Hilton Garden Inn properties this year.

Following on the success of our existing vacation ownership projects at the Flamingo in Las Vegas and at Sea World in Orlando, we will increase our presence in this growing business. Our newest project will open later this year adjacent to the Las Vegas Hilton.

For the last two years, we have dedicated our international efforts to creating and implementing our strategic alliance with Hilton International. Together, we have successfully made Hilton a truly seamless, global brand once again. In 1998 we introduced a new unified logo as well as a joint worldwide advertising campaign, and look forward to initiating additional programs in the months ahead for the benefit of our millions of guests and customers around the world.

Make full and effective use of the capital markets.

We remain strong financially and very well-positioned to continue making good use of the capital markets. Our company has no significant near term debt maturities, strong interest coverage and instant access to a \$1.75 billion revolving credit line on favorable terms.

Invest in our people.

In a business such as ours, it's the people — not the brick and mortar — on whom we depend to deliver on the Hilton promise, and thereby enable us to reach our goals as a company for our investors. There are no better employees in this industry than those who wear the Hilton name badge. We are proud and appreciative of their talents and dedication, and remain committed to devoting the resources necessary to ensure that this team continues to have the skills, motivation and diversity required to keep Hilton #1 in an increasingly competitive and challenging business. We remain dedicated to making our company the best it can be, in terms of our financial health, economic growth and the social aspects of our organization. Providing a diverse environment in all facets of our company continues to be a high priority for management.

We also wish to acknowledge the retirement from the Hilton Hotels Corporation Board of Directors of Eric M. Hilton, whose significant contributions to the company spanned 46 years, and who served the Board with distinction for nine years. We wish Eric well as a new director of Park Place Entertainment, where his valuable insights will be a great asset for that company. We also would like to acknowledge the passing of past president and director emeritus William H. Edwards, Sr. His many accomplishments during a 42-year Hilton career are greatly appreciated.

As we begin writing a new and exciting chapter in the history of our company, we thank you — our shareholders — for your support of our efforts on your behalf. Sitting on the cusp of the millennium, we find a Hilton Hotels Corporation that today, as a focused hotel company, is significantly bigger than the Hilton of three years ago that was then comprised of both lodging and gaming. In today's global lodging industry, size matters; so does the esteem of our brand name, financial strength, asset base, solid growth strategies and a dedicated management and employee team. Put it all together and we have the foundation for a bright and successful future... a future we view with enthusiasm, optimism and an unwavering eye toward customer service and shareholder value.

Respectfully,



BARRON HILTON

Chairman



STEPHEN F. BOLLENBACH

President and Chief Executive Officer



Barron Hilton

Stephen F. Bollenbach

capitalize on the strength of our owned hotels

At Hilton, “keeping our eye on the ball” means essentially keeping our eye on the approximately 40 owned and partially owned hotels in our portfolio. These hotels, as a group, account for roughly 85 percent of our operating cash flow and represent a collection of quality assets that is unmatched in our industry. That’s important. Equally important is that these properties are first-class, highly visible hotels in the very best locations in some of the most heavily visited destination markets in the world — and are emblematic of Hilton style and service.

We are proud of our preeminent positions in such important markets as New York, Chicago, Washington, D.C., San Francisco, New Orleans, Honolulu, San Diego, Atlanta, Charlotte, Dallas, Phoenix, Anchorage, Portland and the Big Island of Hawaii.

To use an old phrase, we know where our bread is buttered. And our attention to maximizing performance at this critical collection of hotels resulted in significant RevPAR and EBITDA gains in 1998 — 5 points and 11 percent, respectively, at our comparable U.S. owned hotels — as well as enhancing our ability to meet and exceed the high expectations of our guests and customers.

For all of the reasons outlined in our letter to shareholders, we continue to believe in the benefits of owning hotel real estate...particularly real estate that features the quality and location characteristics inherent in Hilton’s portfolio. A commitment to dedicating the necessary maintenance and other capital expenditures is key to the continuing outstanding performance of these hotels, and helps ensure we are putting our money where it will generate maximum returns for our shareholders. Two examples particularly stand out:

- Our major refurbishment at the Hilton New York & Towers is well underway and on track for completion by year-end 1999. This \$81 million project ensures that this landmark property in the heart of Rockefeller Center will not only maintain, but strengthen its current position as New York’s premier business and convention hotel. All-new restaurants, a business/conference center equipped for the Information Age, additional rooms, world-class fitness facilities and an exclusive Towers Lounge with a commanding view of New York City will add even further to the Hilton New York’s ability to attract the world’s largest and most prestigious meetings and conventions. These improvements will also provide the services and amenities required by today’s demanding individual business traveler and an increasingly discriminating leisure customer. This program at the Hilton New York is our most visible example of strategic re-investment in our existing hotels.

... these properties are first-class, highly visible hotels in the very best locations
in some of the most heavily visited destination markets in the world...

Located just two blocks from the White House, the **Capital Hilton** is at the center of activity in the Nation's Capital.



The recently renovated **Hilton Portland** is the premier hotel in the "Rose City." A new 319-room tower will be developed in the next three years.



State-of-the-art spacious meeting and convention space and 1,543 guest rooms make the **Hilton Chicago & Towers** the pre-eminent business hotel in the Windy City.



The legendary **Waldorf=Astoria**: timeless elegance, unquestioned quality, and a jewel in Hilton's crown.



capitalize on the strength of our owned hotels

- Boston has emerged as one of the most vibrant lodging markets in the United States, and its airport, Logan International, is one of the world's busiest. By fall 1999, a new Hilton hotel will form the centerpiece of this bustling transportation hub. The \$100 million, 600-room Hilton Boston Logan Airport will feature direct connection to the airport's major terminals via a temperature-controlled skybridge; 30,000 square feet of first-class banquet and convention space; a 6,600-square-foot health club and a fully-equipped Conference Center providing the latest in audio and video teleconferencing capabilities.

Our development strategy has typically been to buy rather than build full-service hotels. However, the relationship with the Massachusetts Transportation Authority coupled with the unique opportunity to be the only hotel in the middle of the world-class Logan Airport facility made this an attractive investment. It's similar to an opportunity we had many years ago at Chicago's O'Hare International Airport, and today the Hilton Chicago O'Hare is among our most popular and profitable hotels. The Hilton Boston Logan Airport is symbolic of strategic and selective new development when and where desirable and economically viable.

Investing and re-investing in our major owned hotels, our primary cash flow generators, is a strategy that complements the view that our full-service properties in these markets will thrive — as a group — in a continuing favorable supply-demand environment for at least the next three to four years. There has rarely been a better time to be an owner of good hotel real estate, but we leave nothing to chance. Balancing profitability and revenue maximization with enhancing the customer's experience — and, if done properly, the latter should lead to the former — is an ever-present goal.

And it's one we take seriously. What we mean by customer "satisfaction" is really customer "loyalty." It's the difference between simply delivering and exceeding the Hilton promise. This balance, this symbiotic relationship of cash flow and customer loyalty is measured every day at every one of our hotels with an eye toward effective management of the Hilton brand, maximization of revenue, operational efficiency and delivery of the Hilton value proposition. The relationship between the excellent performance of our hotels over the last three years and the strong showing in each of these four benchmark measures is not coincidental. By being satisfied with nothing less than perfection in all of these areas, Hilton will continue to be the hotel of choice for the world's business and leisure travelers.

Balancing profitability with enhancing

the customer's experience is an ever-present goal.

acquire full-service hotels

Our company invested \$1 billion in acquiring high quality hotel assets during 1998 and early 1999. Due to the factors outlined in our letter to shareholders — an increase in properties owned by Japanese entities and U.S. insurance companies coming to market; many erstwhile competitors (notably the REITs) lacking the resources to be aggressive acquirers, and limited funding sources for less well capitalized competitors — we anticipate this favorable environment continuing into 1999.

This acquisition activity resulted in our purchasing several outstanding properties, including The Pointe Hilton Resort at Tapatio Cliffs in Phoenix; Hilton Charlotte; Hilton DFW Lakes Executive Conference Center at the Dallas-Ft. Worth Airport; Hilton East Brunswick in New Jersey; an additional 48 percent of the Hilton Hawaiian Village (added to our previous 50 percent ownership); Hilton Short Hills in New Jersey; Hilton McLean Tyson's Corner and the newly renamed Hilton Alexandria Mark Center, both in the Washington, D.C. metropolitan area, and the Hilton La Jolla Torrey Pines near San Diego.

The latter property is particularly noteworthy; a spectacular 394-room hotel, formerly known as the Sheraton Grande Torrey Pines, fronting the world-famous Torrey Pines Golf Courses along the Pacific Coast and near many of San Diego's

tourist attractions, beaches, universities and medical research facilities. Further, this purchase is characteristic of the acquisition climate we find today and expect to find over the next several months.

When we initially bid on the property, ours was the third highest offer. The global economic crisis in the fall made capital for real estate hard to come by, and as a result other potential buyers failed to close on the transaction.

By virtue of our ready access to capital and ability to close quickly, we were the most credible buyer left standing, and were therefore able to acquire the hotel at the attractive price of \$82.5 million, or approximately 7.5 times projected 1999 EBITDA. Not only does this transaction fall comfortably within our return-on-investment target, but we have added yet another fabulous resort — along with the Hilton San Diego Mission Bay — in a thriving, world-class destination, and put another star in our growing universe of owned full-service properties.

It is making prudent and attractive investments such as these — with a careful eye toward not overpaying for assets and achieving excellent rates of return for our shareholders — that will continue to drive our acquisition strategy.

It is making prudent and attractive investments ...

achieving excellent rates of return for our shareholders —

that will continue to drive our acquisition strategy.

One of the most popular resort destinations in the Southwest, the recently acquired **Pointe Hilton at Tapatio Cliffs** features an 18-hole championship golf course and spectacular recreation facilities.



Located directly across the street from Charlotte's convention center, the **Hilton Charlotte** is within walking distance of major corporate headquarters in one of the fastest growing business cities in the U.S.



Breathtaking ocean views, spacious guest rooms and its location adjacent to two world-famous golf courses and renowned research centers signify the **Hilton La Jolla Torrey Pines**.

The 422-room **Hilton Guadalajara** is representative of Hilton Hotels Corporation's growing presence in Mexico, and our growing collection of full-service franchise hotels.



Steps away from the world-famous "Las Vegas Strip," the **Hilton Grand Vacations Club Flamingo** has 200 one and two bedroom suites, access to exciting casino gaming action and is in close proximity to golf and other recreational activities.



There are a few select brands in the world where the name alone is the embodiment of the product or service it represents. So it is with Hilton. But as important as that recognition is, so is the esteem in which our brand name is held throughout the United States and the world. Therefore, one of our major thrusts over the last three years has been to broaden the scope and reach of the Hilton brand. This effort — which has included the creation of our worldwide alliance with Hilton International and introduction of Hilton Garden Inn hotels — will continue in 1999 and into the next century.

In North America our franchisees will open more than 65 Garden Inn properties in 1999, following a year in which we approved 40 Hilton Garden Inns for construction, bringing our current total to more than 140 either open or under construction across the United States, Canada and Mexico. These fresh new mid-priced hotels are receiving high marks from our owners, as well as getting outstanding reviews for comfort, atmosphere and value from our guests and customers.

We have also been aggressively adding high-quality full-service franchised hotels to the Hilton collection. During 1998 we added domestic properties in Louisville, Kentucky; Hartford, Connecticut; Jackson, Mississippi; Monterey, California; Clearwater Beach, Florida, and Tulsa, Oklahoma, as well as hotels in Mexico (Guadalajara and Mexico City International Airport) and Canada (Montreal and Windsor.)

The bottom line is that we can expect franchise fee income to grow by more than 50 percent by 2001.

Vacation ownership, a fast-growing segment of the leisure industry, has so far been a fairly small, but successful, part of our company. The reach of our existing resort hotel properties across the United States — including Hawaii, Arizona, Southern California, Florida, Georgia and South Carolina — and our ability to market vacation ownership to millions of potential customers through Hilton hotels and Park Place Entertainment's hotel-casinos in Nevada, New Jersey and Mississippi, support our intention to strengthen our position in this business. Our newest facility, located adjacent to the Las Vegas Hilton, will feature 232 well-equipped one and two bedroom suites and will open late this year.

Beyond the borders of the United States, our two-year relationship with Hilton International gets stronger by the year. We continue to open the doors of Hilton hotels worldwide to an ever-increasing base of customers.

Hilton guests around the world can now receive the benefits inherent in our industry-leading Hilton HHonors loyalty program... a program that now has approximately 2 million members, up from 1.5 million before the Hilton International alliance. And with some 35 sales offices in such major international business and financial centers as New York, London, Tokyo, Frankfurt and Buenos Aires, our two companies have made it easier for meeting and convention planners to book business at Hilton properties worldwide.

Dotting the "i" in creating a single Hilton network for our guests and customers, 1998 saw the introduction of a new global advertising campaign — "It Happens At The Hilton" — the first truly international advertising program for Hilton in nearly a decade. This new campaign is being complemented by an exciting, innovative new worldwide logo that will help further communicate a seamless system of nearly 500 hotels setting a standard of hospitality excellence around the world.

financial overview

Riding the continued strength of our major market, owned full-service hotels, along with the significant contribution of acquisitions made during the year, the financial performance of Hilton Hotels Corporation in 1998 — which reflects the spin-off of Park Place Entertainment — was very good indeed.

Income from continuing operations for 1998 was \$188 million, or \$.71 per diluted share, compared to \$183 million, or \$.68 per diluted share, in 1997. The company's proportionate share of costs associated with the gaming spin-off impacted EPS by \$.04 per diluted share, while 1997 EPS, due to costs associated primarily with the ITT acquisition effort, was also impacted by \$.04 per diluted share. Average diluted shares outstanding were 278 million at year-end 1998 compared with 281 million at the end of 1997.

Earnings before interest, taxes, depreciation, amortization and non-cash items (EBITDA) rose 20 percent to \$596 million from last year's \$497 million. On a recurring basis, giving effect to certain costs — \$13 million in 1998 for the gaming spin-off and \$16 million in 1997 due primarily to the ITT effort — EBITDA for the year was \$609 million, up 19 percent from \$513 million.

Our U.S. owned and partially owned hotels reported very strong results in 1998. These hotels contributed \$544 million of EBITDA, with comparable EBITDA increasing 11 percent over last year. Revenue per available room (RevPAR) was up almost five percent. It is interesting to note that when excluding the Hilton Hawaiian Village in Honolulu and the Hilton Waikoloa Village on the Big Island of Hawaii — both of

which continue to feel the adverse effects of poor economic conditions in Asia — the comparable EBITDA increase was 17 percent, while RevPAR rose an impressive seven percent.

The strength of these continental U.S. properties, coupled with a generally positive outlook for the U.S. economy, give us confidence in our ability to achieve 1999 RevPAR gains in the four to five percent range, translating to same-store EBITDA growth of eight to ten percent. Our business plan is to supplement this EBITDA growth with smart acquisitions, expanding franchising efforts, particularly with our Hilton Garden Inns, and selective new development. The successful implementation of this plan should enable us to realize significant net income and EBITDA growth in 1999.

To fuel our growth and deliver the results expected by our shareholders, it is important that we maintain a solid financial position and continue to make effective use of the capital markets as opportunities arise. We begin 1999 in excellent financial condition, with an investment grade credit rating that was reaffirmed following the spin-off of our gaming operations.

After separating our gaming and lodging businesses and allocating the debt between the two companies, Hilton Hotels Corporation has a substantially undrawn \$1.75 billion revolving credit line — a major advantage in a world of tightening liquidity — that can be used for acquisitions and/or to repurchase stock as appropriate and desirable for the enhancement of value for our shareholders.

financial information

18 Management's Discussion and Analysis	24 Consolidated Statements of Income	25 Consolidated Balance Sheets	26 Consolidated Statements of Cash Flow	27 Consolidated Statements of Stockholders' Equity	28 Notes to Consolidated Financial Statements
36 Report of Independent Public Accountants	37 Supplementary Financial Information	39 Five Year Summary			



Hilton Washington & Towers



Hilton Garden Inn Raleigh-Durham



Hilton San Diego Mission Bay Resort

On December 31, 1998, Hilton Hotels Corporation ("Hilton" or the "Company") completed a spin-off that split the Company's operations into two independent public corporations, one for conducting its hotel business and one for conducting its gaming business. Hilton has retained ownership of the hotel business. Hilton transferred the gaming business to a new corporation named Park Place Entertainment Corporation ("Park Place"), and distributed the stock of Park Place tax-free to Hilton stockholders on a one-for-one basis. As a result of the spin-off, Hilton's historical financial statements have been restated to reflect the gaming business as discontinued operations. The following discussion and analysis of financial condition and results of operations is that of Hilton's continuing operations.

FINANCIAL CONDITION

Liquidity

Net cash provided by operating activities totaled \$390 million and \$229 million for the years ended December 31, 1998 and 1997, respectively. The increase was primarily attributable to continued strength at many of the Company's owned and partially owned full-service hotels and the benefit of cash flow from newly acquired hotel properties.

Acquisitions and Capital Spending

Net cash used in investing activities was \$1,062 million in 1998 compared to \$60 million in 1997. The increase was due primarily to new hotel acquisitions and construction costs. In addition, the 1997 period reflects \$123 million of cash proceeds from asset sales, primarily the sale of the Company's interest in the Conrad International Hong Kong. Expenditures required to complete acquisitions and capital spending programs in 1999 will be financed through available cash flows and general corporate borrowings.

Growth in the hotel segment continues through selective acquisition of large full-service hotels in major market locations. In December 1997 and January 1998, the Company acquired the remaining interests in the Hilton Chicago & Towers, Hilton San Francisco & Towers, Hilton Washington & Towers, Hilton Rye Town and Capital Hilton from The Prudential Insurance Company of America ("Prudential"), thereby increasing the Company's ownership interest in each property to 100%.

In January 1998, the Company purchased The Prospect Company's 92.5% ownership interest in the 458-room Hilton McLean Tysons Corner in McLean, Virginia located just outside Washington D.C., thereby increasing the Company's ownership

interest to 100%. In March 1998, the Company purchased the 300-room Hilton Short Hills, a "Five Diamond" hotel located in Short Hills, New Jersey.

In April 1998, the Company purchased the 407-room Westin Hotel in Charlotte, North Carolina (re-named the Hilton Charlotte & Towers) and the 395-room Hilton DFW Lakes Executive Conference Center at the Dallas-Ft. Worth International Airport. In July 1998, the Company purchased the 405-room Hilton East Brunswick & Towers in East Brunswick, New Jersey.

In June 1998, the Company entered into an agreement with Prudential to restructure their joint venture ownership of the 2,545-room Hilton Hawaiian Village, and in September 1998, the Company increased its investment in the joint venture from 50% to 98%. In August 1998, the Company acquired a 75% interest in the 585-room Pointe Hilton Tapatio Cliffs Resort in Phoenix, Arizona.

In December 1998, the Company purchased the 394-room Sheraton Grande Torrey Pines (re-named the Hilton La Jolla Torrey Pines). The Company leases the land underlying the hotel. The resort is located adjacent to two world-famous Torrey Pines Golf Courses along the Pacific Coast in La Jolla, California.

The hotel acquisitions completed during 1998 totaled approximately \$950 million, including the assumption of debt. Each of these acquisitions was completed at a discount to replacement cost. In February 1999, the Company acquired the 495-room Radisson Plaza Hotel at Mark Center in Alexandria, Virginia (re-named the Hilton Alexandria Mark Center) for approximately \$52 million. The Company expects to make further acquisitions in 1999.

The Company is currently renovating the Hilton New York & Towers. This project, which includes new restaurants, a state-of-the-art business/conference center, a world-class fitness facility and an exclusive Towers Lounge overlooking Manhattan, is expected to be completed in late 1999. Renovation and construction projects are also underway at the Hilton Seattle Airport and the Hilton Portland. The Seattle project includes renovating existing rooms and constructing a 222-room addition, while the Portland project involves construction of a 319-room tower addition. The Company is also in the process of constructing a new 600-room hotel at the center of Boston's Logan Airport and a 232-unit vacation ownership resort adjacent to the Las Vegas Hilton, both of which are expected to open in late 1999.

In addition to an estimated \$200 million in 1999 expenditures related to the aforementioned renovation and construction projects, the Company intends to spend approximately \$140 million in 1999 on normal capital replacements, upgrades and compliance projects.

Other Developments

The Company continues to improve its franchise business through the expansion of the Hilton Garden Inn product, the addition of high quality full-service properties and the removal of properties that do not meet the Company's standards. In 1998, 11 franchise contracts, representing some 3,300 rooms, were terminated. Ten full-service properties and approximately 3,200 rooms were added to the franchise system in 1998. The Company added nine Garden Inn properties in 1998, expects to open approximately 65 during 1999 and anticipates having 200 such franchise properties either open or under construction in 2000.

Financing

Long-term debt at December 31, 1998 totaled \$3.0 billion, compared with \$1.4 billion at December 31, 1997. The 1998 balance includes additional borrowings to fund acquisitions and capital expenditures and increased debt related to the restructuring of the Hilton Hawaiian Village joint venture. Cash provided by financing activities totaled \$362 million in 1998 and cash used in financing activities totaled \$15 million in 1997.

The 1998 debt balance includes \$625 million of long-term debt which, although allocated to Park Place under a debt assumption agreement, remains the legal obligation of Hilton. At the time of the spin-off, Park Place assumed and agreed to pay 100% of the amount of each payment required to be made by Hilton under the terms of the indentures governing Hilton's \$300 million 7.375% Senior Notes due 2002 and its \$325 million 7% Senior Notes due 2004. These notes remain in Hilton's long-term debt balance and a long-term receivable from Park Place in an equal amount is included in the Company's 1998 consolidated balance sheet. In the event of an increase in the interest rate on these notes as a result of certain actions taken by Hilton or in certain other limited circumstances, Hilton will be required to reimburse Park Place for any such increase. Hilton is obligated to make any payment Park Place fails to make, and in such event Park Place shall pay to Hilton the amount of such payment together with interest, at the rate per annum borne by the applicable notes plus two percent, to the date of reimbursement.

In order to facilitate the transfer of debt balances in connection with the spin-off, in December 1998 Park Place entered into a long-term credit facility and completed a senior subordinated note offering. Park Place used the proceeds from the new facility and note offering to repay \$1,066 million of Hilton's commercial paper borrowings,

representing an estimate of Park Place's share of the obligation. The distribution agreement entered into between Hilton and Park Place calls for a final reconciliation and allocation of certain debt and cash balances, as defined. The reconciliation resulted in an additional amount due Hilton from Park Place of \$73 million. This balance is reflected in current assets in the accompanying 1998 consolidated balance sheet. A pro rata portion of Hilton's historical outstanding public and corporate bank debt balances and related interest expense has been allocated to Park Place for prior periods.

By virtue of the aforementioned agreement with Prudential to restructure the joint venture ownership of the Hilton Hawaiian Village, effective June 1, 1998 the Company was deemed to control the joint venture, thus requiring consolidation of this previously unconsolidated entity. The agreement also called for the refinancing of the joint venture's existing debt under a new joint venture revolving credit facility. In accordance with the terms of the agreement, this new facility was used to borrow an additional \$294 million which was loaned to a Prudential affiliate and subsequently redeemed to increase the Company's investment in the joint venture from 50% to 98%. The consolidation of the joint venture, which includes the total borrowings under the new facility, resulted in an increase in consolidated debt of \$480 million.

At December 31, 1998, \$155 million of the aggregate commitment of the Company's five year \$1.75 billion revolving credit facility was outstanding, leaving approximately \$1.6 billion available to the Company at such date.

In October 1997, the Company filed a shelf registration statement ("Shelf") with the Securities and Exchange Commission registering up to \$2.5 billion in debt or equity securities. At December 31, 1998, available financing under the Shelf totaled \$2.1 billion. The terms of any additional securities offered pursuant to the Shelf will be determined by market conditions at the time of issuance.

Pursuant to the Company's stock repurchase program, during the 1998 first quarter the Company repurchased 2.8 million shares of common stock, or 14 percent of the total authorized to be repurchased, for an aggregate purchase price of \$81 million. The Company may, at any time, repurchase up to 15.7 million remaining shares authorized for repurchase pursuant to such program. The timing of stock repurchases are made at the discretion of the Company's management, subject to certain business and market conditions.

In accordance with the terms of the indenture governing the Company's \$500 million 5% Convertible Subordinated Notes due 2006, effective January 4, 1999, the conversion price was adjusted to \$22.17, reflecting the gaming spin-off.

Stockholders' Equity

Stockholders' equity totaled \$187 million at December 31, 1998, reflecting the spin-off of the gaming operations. Dividends paid on common shares were \$.32 per share in 1998 and 1997 and \$.305 per share in 1996. Dividends are expected to be \$.08 per share in 1999.

In October 1998, 14.8 million shares of the Company's Preferred Redeemable Increased Dividend Equity Securities, 8% PRIDES, Convertible Preferred Stock were converted into 13.6 million shares of common stock.

RESULTS OF OPERATIONS

The following discussion presents an analysis of the Company's results of operations for the years ended December 31, 1998, 1997 and 1996. EBITDA (earnings before interest, taxes, depreciation, amortization and non-cash items) is presented supplementally in the tables below and in the discussion of operating results because management believes it allows for a more complete analysis of results of operations. Non-cash items, such as asset write-downs and impairment losses, are excluded from EBITDA as these items do not impact operating results on a recurring basis. This information should not be considered as an alternative to any measure of performance as promulgated under generally accepted accounting principles (such as operating income or net income), nor should it be considered as an indicator of the overall financial performance of the Company. The Company's calculation of EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

Fiscal 1998 Compared with Fiscal 1997

Overview

A summary of the Company's consolidated revenue and earnings for the years ended December 31, 1998 and 1997 is as follows:

(in millions, except per share amounts)	1998	1997	% Change
Revenue	\$1,769	1,475	20%
Operating income	464	395	17
Income from continuing operations	188	183	3
Income from discontinued gaming operations	109	67	63
Net income	297	250	19
Basic EPS			
Income from continuing operations	\$.71	.68	4%
Discontinued gaming operations	.44	.27	63
Net income per share	\$ 1.15	.95	21%
Diluted EPS			
Income from continuing operations	\$.71	.68	4%
Discontinued gaming operations	.41	.26	58
Net income per share	\$ 1.12	.94	19%
Other Operating Data			
EBITDA			
Operations	\$ 660	561	18%
Corporate expense, net	(64)	(64)	—
Total	\$ 596	497	20%

The Company's continuing operations include the consolidated results of the Company's owned, partially owned and leased hotel assets. Consolidated results also include equity income from unconsolidated affiliates, management and franchise fees and earnings from vacation ownership operations. At December 31, 1998 the Company owned or partially owned ("owned"), managed and franchised 37, 24 and 188 hotel properties, respectively, totaling approximately 87,000 rooms worldwide.

Total revenue for 1998 was \$1.8 billion, an increase of 20 percent over 1997. EBITDA from operations was \$660 million for 1998, an 18 percent increase compared to 1997, while total EBITDA was \$596 million for 1998, a 20 percent increase over the prior year. Total operating income increased 17 percent to \$464 million.

The Company's results are significantly influenced by the operating performance of its owned portfolio of major market domestic full-service properties. Operating performance is primarily affected by volume (as measured by occupancy), pricing (as measured by average room rate), the Company's ability to manage costs and the growth in the number of available rooms through acquisition and development. The Company's domestic owned hotels generated \$544 million of EBITDA in 1998, with

comparable EBITDA increasing 11 percent over the prior year. EBITDA margins at these hotels improved two points to 34 percent. The comparable EBITDA increase improved to 17 percent when excluding the Hilton Hawaiian Village in Honolulu and the Hilton Waikoloa Village on the island of Hawaii, both of which continue to feel the effects of the Asian economic crisis. Occupancy in 1998 at comparable owned hotels declined 2.5 points to 75 percent, with the average rate increasing 8.3 percent to \$166.47, resulting in a 4.8 percent improvement in revenue per available room ("RevPAR"). Without the Company's Hawaii operations, RevPAR for the year at this group of properties increased 7.1 percent.

Combined EBITDA from the Waldorf=Astoria and the Hilton New York & Towers increased \$24 million or 22 percent over the prior year. RevPAR gains of 10 and 11 percent, respectively, were driven by strong rate gains in both the leisure and individual business traveler ("IBT") segments. Combined EBITDA from the Hilton Chicago & Towers, the Hilton Chicago O'Hare Airport and the Palmer House Hilton increased \$20 million or 26 percent over the prior year. All three properties maintained strong volume and achieved double-digit rate growth in the IBT segment. Combined EBITDA margins at these three Chicago properties averaged 35 percent, a five point increase from 1997. Results also benefited from a combined EBITDA increase of \$11 million from the San Diego and San Francisco Hiltons. The San Diego property benefited from strong rate increases in all segments and a seven point improvement in EBITDA margin. The impact of reduced leisure demand at the Hilton San Francisco & Towers was offset by an increase in higher rate IBT room nights. EBITDA from the Hilton New Orleans Riverside & Towers increased \$4 million or nine percent from the prior year. Occupied rooms at this property remained flat year over year, however decreased leisure volume was replaced with higher rate convention and IBT business. Growth was negatively impacted by results at the Hilton Hawaiian Village and the Hilton Waikoloa Village. On a comparable basis, EBITDA at these properties declined 13 percent and 12 percent, respectively.

Acquisition activity, including increased ownership of properties which were previously partially owned and new property acquisitions, added \$47 million of EBITDA in 1998. The Company acquired or increased its ownership interest in eight full-service domestic properties during 1998.

Results from the Company's vacation ownership operations increased \$6 million or 32 percent from the prior year, primarily due to strong interval sales at the Company's Orlando development. Total unit weeks sold increased 34 percent from the prior year. The Company expects the income contribution from its vacation ownership operations to increase in 1999 with the opening of a new development adjacent to the Las Vegas Hilton.

Management and franchise fee revenue decreased \$11 million in 1998 to \$104 million. This decrease is attributable primarily to the acquisition of several previously managed properties during 1998, reduced management fees from the Conrad International Hong Kong, which was negatively impacted by economic conditions in Asia, and a \$1 million decrease in initial and termination fees from franchise properties. Fee revenue is based primarily on operating revenue at managed properties and rooms revenue at franchised properties.

Depreciation and amortization, including the Company's proportionate share of depreciation and amortization from its unconsolidated affiliates, increased \$28 million in 1998 to \$132 million due primarily to new acquisitions.

Although the supply-demand balance in the Company's major markets generally remains favorable, future operating results could be adversely impacted by increased capacity and weak demand. These conditions could limit the Company's ability to pass through inflationary increases in operating costs in the form of higher rates. Increases in transportation and fuel costs or sustained recessionary periods in the U.S. (affecting domestic travel) and internationally (affecting inbound travel from abroad) could also unfavorably impact future results. However, the Company believes that its financial strength and market presence will enable it to remain extremely competitive.

Corporate Expense, Net

Corporate expense increased \$2 million in 1998 to \$67 million. The 1998 expense includes the Company's proportionate share of costs associated with the gaming spin-off totaling \$13 million. The 1997 expense includes \$25 million in costs related to the Company's efforts to acquire ITT Corporation ("ITT"). The 1997 costs were partially offset by a \$10 million gain recognized on the sale of ITT stock previously purchased by the Company.

Financing Activities

Interest and dividend income decreased \$4 million compared with the prior year, primarily due to lower investment balances. Interest expense, net of amounts capitalized, increased \$47 million reflecting higher debt levels due to acquisition activity during the year and a higher average cost of debt resulting from the Company issuing long-term notes to replace floating rate debt in 1997. Net interest expense from unconsolidated affiliates decreased \$4 million, reflecting the mid-year consolidation of the Hilton Hawaiian Village.

Income Taxes

The effective income tax rate in 1998 increased to 40.5% from 39.5% in 1997. The Company's effective income tax rate is determined by the level and composition of pretax income and the mix of income subject to varying foreign, state and local taxes.

Fiscal 1997 Compared with Fiscal 1996

Overview

A summary of the Company's consolidated revenue and earnings for the years ended December 31, 1997 and 1996 is as follows:

(in millions, except per share amounts)	1997	1996	% Change
Revenue	\$ 1,475	947	56%
Operating income	395	237	67
Income from continuing operations	183	120	53
Income (loss) from discontinued gaming operations	67	(38)	—
Net income	250	82	205
Basic EPS			
Income from continuing operations	\$.68	.61	11%
Discontinued gaming operations	.27	(.20)	—
Net income per share	\$.95	.41	132%
Diluted EPS			
Income from continuing operations	\$.68	.61	11%
Discontinued gaming operations	.26	(.20)	—
Net income per share	\$.94	.41	129%
Other Operating Data			
EBITDA			
Operations	\$ 561	401	40%
Corporate expense, net	(64)	(40)	60
Total	\$ 497	361	38%

Consolidated revenue increased 56 percent in 1997 to \$1.5 billion. EBITDA from operations was \$561 million for 1997, a 40 percent increase compared to 1996, while total EBITDA increased 38 percent in 1997 to \$497 million. Operating income increased 67 percent to \$395 million.

Combined EBITDA from the Company's owned domestic properties totaled \$454 million, with comparable EBITDA increasing 13 percent over the prior year. The EBITDA increase improved to 16 percent when excluding the Hilton Hawaiian Village. Occupancy in 1997 at comparable owned hotels was flat compared to 1996 at 77.8 percent, with the average rate increasing 8.7 percent to \$153.18, resulting in a nine percent improvement in RevPAR. Excluding the Hilton Hawaiian Village, RevPAR for the year at this group of properties increased 10.2 percent.

Combined EBITDA from the Waldorf=Astoria and the Hilton New York & Towers increased \$22 million compared to 1996. Strong demand, particularly in the leisure and the higher rate IBT segments, contributed to a double-digit RevPAR increase at each of these two properties. Double-digit percentage gains in average room rates and RevPAR led the Hilton San Francisco & Towers to an \$8 million or 25 percent increase in EBITDA compared to 1996. Increased convention volume at the Hilton Washington & Towers

and strong IBT growth at the Capital Hilton led to a combined EBITDA increase of \$8 million at these properties in 1997. Combined EBITDA from the Hilton Hawaiian Village, impacted by the poor economic conditions in Asia, and the Hilton New Orleans Riverside & Towers, impacted by the closure of the Flamingo Casino-New Orleans and a weak city-wide convention year, was even with the prior year.

Acquisition activity, including increased ownership of properties which were previously partially owned and new property acquisitions, added \$67 million of EBITDA in 1997. The Company acquired or increased its ownership interest in seven full-service domestic properties in late 1996 and 1997.

Management and franchise fee revenue increased \$10 million in 1997 to \$115 million. Initial and termination fees from franchise properties increased \$3 million.

Depreciation and amortization, including the Company's proportionate share of depreciation and amortization from its unconsolidated affiliates, increased \$2 million in 1997 to \$104 million.

Hotel results were adversely effected by \$25 million of non-recurring charges (\$22 million non-cash) in 1996. These charges included the write-down of certain investments and notes receivable to estimated fair market value.

Corporate Expense, Net

Corporate expense increased \$22 million in 1997 to \$65 million. The 1997 expense includes net costs related to the Company's efforts to acquire ITT and increased costs associated with the Company's development of its Hilton Garden Inn product.

Financing Activities

Interest and dividend income decreased \$9 million compared with the prior year. Interest expense, net of amounts capitalized, increased \$38 million primarily due to acquisition activity in late 1996 and early 1997. Net interest expense from unconsolidated affiliates increased \$1 million over 1996.

Income Taxes

The effective income tax rate in 1997 was 39.5% compared to 38.7% in 1996.

OTHER MATTERS

Year 2000

The Company is currently working to resolve the potential impact of the Year 2000 on the processing of date-sensitive information by its computerized information systems. The Year 2000 problem is the result of computer programs being written using two digits (rather than four) to define the applicable year. Any of the Company's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000, which could result in miscalculations or system failures.

The Company has a Year 2000 program, the objective of which is to determine and assess the risks of the Year 2000 issue, and plan and institute mitigating actions to minimize those risks. The Company's standard for compliance requires that for a computer system or business process to be Year 2000 compliant, it must be designed to operate without error in date and date-related data prior to, on and after January 1, 2000. The Company expects to be fully Year 2000 compliant with respect to all significant business systems prior to December 31, 1999.

The Company's various project teams are focusing their attention in the following major areas:

Information Technology ("IT") Systems

Information technology systems account for much of the Year 2000 work and include all computer systems and technology managed by the Company. The Company has assessed these core systems, has plans in place, and is undertaking to test and implement changes where required. The Company has not yet identified any significant remediation. The Company has contacted appropriate vendors and suppliers as to their Year 2000 compliance and their deliverables have been factored into the Company's plans.

Non-IT Systems

The Company has completed an inventory of all property level non-IT systems (including elevators, electronic door locks, etc.). The Company has assessed the majority of these non-IT systems, has plans in place, and is undertaking to test and implement changes where required. The Company has contacted appropriate vendors and suppliers as to their Year 2000 compliance and their deliverables have been factored into the Company's plans.

Suppliers

The Company is communicating with its significant suppliers to understand their Year 2000 issues and how they might prepare themselves to manage those issues as they relate to the Company. To date, no significant supplier has informed the Company that a material Year 2000 issue exists which will have a material effect on the Company.

During 1999, the Company will continually review its progress against its Year 2000 plans and determine what contingency plans are appropriate to reduce its exposure to Year 2000 related issues.

Based on the Company's current assessment, the costs of addressing potential problems are expected to be less than \$3 million. However, if the Company is unable to resolve its Year 2000 issues, contingency plans to update existing systems (i.e., reservation, payroll, etc.) are in place for which the Company expects the cost,

if any, to be an additional \$3 million. If the Company's customers or vendors identify significant Year 2000 issues in the future and are unable to resolve such issues in a timely manner, it could result in a material financial risk. Accordingly, the Company plans to devote the necessary resources to resolve all significant Year 2000 issues in a timely manner.

Recent Accounting Pronouncements

In April 1998, the AICPA issued Statement of Position ("SOP") 98-5, "Reporting on the Costs of Start-Up Activities." This SOP requires that all nongovernmental entities expense costs of start-up activities (pre-opening, pre-operating and organizational costs) as those costs are incurred and requires the write-off of any unamortized balances upon implementation. SOP 98-5 is effective for financial statements issued for periods beginning after December 15, 1998. The Company will adopt SOP 98-5 in the first quarter of 1999. Adoption of the SOP is not expected to have a material impact on the 1999 results of operations.

Other

Various lawsuits are pending against the Company. In management's opinion, disposition of these lawsuits is not expected to have a material effect on the Company's financial position or results of operations.

FORWARD-LOOKING STATEMENTS

Forward-looking statements in this report, including without limitation, those set forth under the captions "Financial Overview," "Financial Condition," "Results of Operations," and "Other Matters," and statements relating to the Company's 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" and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect the Company's current views with respect to future events and financial performance, and are subject to certain risks and uncertainties, including those identified above under "Results of Operations" and those in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998 under the captions "Additional Information – Business Risks," and "Competition," the effect of economic conditions, and customer demand, which could cause actual results to differ materially from historical results or those anticipated. Although the Company believes the expectations reflected in such forward-looking statements are based upon reasonable assumptions, it can give no assurance that its expectations will be attained.

consolidated statements of income

(in millions, except per share amounts)

Year Ended December 31, 1998

1997

1996

Revenue

Rooms	\$ 952	779	441
Food and beverage	414	326	188
Management and franchise fees	104	115	105
Other revenue	299	255	213
	<u>1,769</u>	<u>1,475</u>	<u>947</u>

Expenses

Rooms	237	205	127
Food and beverage	315	254	147
Other expenses	686	556	393
Corporate expense, net	67	65	43
	<u>1,305</u>	<u>1,080</u>	<u>710</u>

Operating Income

Interest and dividend income	464	395	237
Interest expense	13	17	26
Interest expense, net, from unconsolidated affiliates	(137)	(90)	(52)
	<u>(4)</u>	<u>(8)</u>	<u>(7)</u>

Income Before Income Taxes and Minority Interest

Provision for income taxes	336	314	204
Minority interest, net	136	124	79
	<u>12</u>	<u>7</u>	<u>5</u>

Income from Continuing Operations

Income (loss) from discontinued gaming operations, net of tax provision (benefit) of \$111, \$63 and \$(25)	188	183	120
	<u>109</u>	<u>67</u>	<u>(38)</u>

Net Income

	<u>\$ 297</u>	<u>250</u>	<u>82</u>
Change in unrealized gains and losses, net of tax	(19)	7	11
Comprehensive income	<u>\$ 278</u>	<u>257</u>	<u>93</u>

Basic Earnings Per Share

Income from continuing operations	\$.71	.68	.61
Discontinued gaming operations	.44	.27	(.20)
Net income per share	<u>\$ 1.15</u>	<u>.95</u>	<u>.41</u>

Diluted Earnings Per Share

Income from continuing operations	\$.71	.68	.61
Discontinued gaming operations	.41	.26	(.20)
Net income per share	<u>\$ 1.12</u>	<u>.94</u>	<u>.41</u>

See notes to consolidated financial statements

consolidated balance sheets

(in millions)

December 31, 1998

1997

ASSETS

Current Assets

Cash and equivalents	\$ 47	5
Accounts receivable, net of allowance of \$12 and \$6, respectively	204	155
Receivable from discontinued gaming operations	73	—
Inventories	54	39
Deferred income taxes	48	31
Other current assets	43	32
Total current assets	469	262

Investments, Property and Other Assets

Investments	262	233
Long-term receivable	625	—
Property and equipment, net	2,483	1,373
Net assets of discontinued gaming operations	—	3,381
Other assets	105	29
Total investments, property and other assets	3,475	5,016

Total Assets

\$3,944 5,278

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities

Accounts payable and accrued expenses	\$ 410	268
Current maturities of long-term debt	62	31
Income taxes payable	34	9
Total current liabilities	506	308

Long-term debt	3,037	1,437
Deferred income taxes	65	36
Insurance reserves and other	149	114
Total liabilities	3,757	1,895

Commitments and Contingencies

Stockholders' Equity

8% PRIDES convertible preferred stock	—	15
Common stock, 261 and 249 shares outstanding, respectively	663	628
Additional paid-in capital	—	1,759
Retained (deficit) earnings	(347)	1,040
Other	—	11
	316	3,453

Less treasury stock, at cost	129	70
Total stockholders' equity	187	3,383

Total Liabilities and Stockholders' Equity

\$3,944 5,278

See notes to consolidated financial statements

consolidated statements of cash flow

(in millions)

Year Ended December 31, 1998

1997

1996

Operating Activities

Net income	\$ 297	250	82
Adjustments to reconcile net income to net cash provided by operating activities:			
(Income) loss from discontinued gaming operations	(109)	(67)	38
Depreciation and amortization	125	93	67
Non-cash items	—	(2)	22
Amortization of loan costs	2	1	1
Change in working capital components:			
Inventories	(15)	10	(42)
Accounts receivable	(42)	5	(44)
Other current assets	(17)	(5)	(8)
Accounts payable and accrued expenses	124	4	135
Income taxes payable	25	4	(8)
Change in deferred income taxes	9	(63)	(11)
Change in other liabilities	5	(46)	(10)
Unconsolidated affiliates' distributions (less than) in excess of earnings	(17)	6	37
Other	3	39	26
Net cash provided by operating activities	390	229	285

Investing Activities

Capital expenditures	(171)	(93)	(49)
Additional investments	(98)	(97)	(53)
Change in temporary investments	—	25	53
Proceeds from asset sales	—	123	—
Payments on notes and other	49	49	1
Acquisitions, net of cash acquired	(842)	(67)	(432)
Net cash used in investing activities	(1,062)	(60)	(480)

Financing Activities

Change in commercial paper borrowings and revolving loans	355	(1,218)	1,041
Long-term borrowings	400	1,393	492
Reduction of long-term debt	(247)	(95)	(1,457)
Issuance of common stock	25	38	31
Purchase of common stock	(81)	(40)	—
Cash dividends	(90)	(93)	(60)
Net cash provided by (used in) financing activities	362	(15)	47

Net transfers from (to) discontinued gaming operations

352 (191) (110)

Increase (Decrease) in Cash and Equivalents

42 (37) (258)

Cash and Equivalents at Beginning of Year

5 42 300

Cash and Equivalents at End of Year

\$ 47 5 42

See notes to consolidated financial statements

consolidated statements of stockholders' equity

(in millions, except per share amounts)	8% PRIDES Convertible Preferred Stock	Common Stock	Additional Paid-in Capital	Retained (Deficit) Earnings	Other	Treasury Stock
Balance, December 31, 1995	\$ —	494	—	909	(7)	(142)
Exercise of stock options	—	—	—	—	—	31
Bally acquisition	15	133	1,735	—	—	—
Cumulative translation adjustment, net of deferred tax	—	—	—	—	6	—
Change in unrealized gain/loss on marketable securities, net of deferred tax	—	—	—	—	5	—
Deferred compensation	—	—	10	—	—	—
Net income	—	—	—	82	—	—
Dividends (\$.305 per share)	—	—	—	(60)	—	—
Balance, December 31, 1996	15	627	1,745	931	4	(111)
Issuance of common stock	—	1	4	—	—	5
Exercise of stock options	—	—	—	(48)	—	76
Treasury stock acquired	—	—	—	—	—	(40)
Cumulative translation adjustment, net of deferred tax	—	—	—	—	(4)	—
Change in unrealized gain/loss on marketable securities, net of deferred tax	—	—	—	—	11	—
Deferred compensation	—	—	10	—	—	—
Net income	—	—	—	250	—	—
Dividends	—	—	—	—	—	—
PRIDES (\$.89 per share)	—	—	—	(13)	—	—
Common (\$.32 per share)	—	—	—	(80)	—	—
Balance, December 31, 1997	15	628	1,759	1,040	11	(70)
Issuance of common stock	—	1	10	—	—	—
Exercise of stock options	—	—	—	(8)	—	22
Treasury stock acquired	—	—	—	—	—	(81)
Conversion of PRIDES	(15)	34	(19)	—	—	—
Cumulative translation adjustment, net of deferred tax	—	—	—	—	(9)	—
Change in unrealized gain/loss on marketable securities, net of deferred tax	—	—	—	—	(10)	—
Deferred compensation	—	—	10	—	—	—
Net income	—	—	—	297	—	—
Dividends	—	—	—	—	—	—
PRIDES (\$.67 per share)	—	—	—	(10)	—	—
Common (\$.32 per share)	—	—	—	(80)	—	—
Spin-off of Park Place Entertainment Corporation	—	—	(1,760)	(1,586)	8	—
Balance, December 31, 1998	\$ —	663	—	(347)	—	(129)

See notes to consolidated financial statements

notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1998

BASIS OF PRESENTATION AND ORGANIZATION

On December 31, 1998, Hilton Hotels Corporation ("Hilton" or the "Company") completed a spin-off that split the Company's operations into two independent public corporations per an agreement dated June 30, 1998, one for conducting its hotel business and one for conducting its gaming business. Hilton retained ownership of the hotel business. Hilton transferred the gaming business to a new corporation named Park Place Entertainment Corporation ("Park Place") and distributed the stock of Park Place tax-free to Hilton stockholders on a one-for-one basis. As a result of the spin-off, Hilton's financial statements reflect the gaming business as discontinued operations. Also on December 31, 1998, immediately following the spin-off, Park Place acquired, by means of a merger, the Mississippi Gaming Business of Grand Casinos, Inc. ("Grand").

Hilton is primarily engaged in the ownership, management and development of hotels, resorts and vacation ownership properties and the franchising of lodging properties. Hilton operates in select markets throughout the world, predominately in the United States.

SPIN-OFF OF GAMING OPERATIONS

As discussed above, on December 31, 1998, the Company completed a spin-off of its gaming operations. Accordingly, results of operations and cash flows of Park Place have been reported as discontinued operations for all periods presented in the consolidated financial statements of Hilton. The consolidated balance sheet as of December 31, 1997 also reflects the Company's gaming business as discontinued operations. Summarized financial information of the discontinued operations is presented in the following tables:

Net assets of discontinued gaming operations:

(in millions)	1997
Current assets	\$ 450
Current liabilities	334
Net current assets	116
Property and equipment, net	3,621
Other assets	1,559
Long-term debt, including allocated debt	1,272
Other liabilities and deferred taxes	643
Net assets of discontinued gaming operations	<u>\$3,381</u>

Income (loss) from discontinued gaming operations:

(in millions)	1998	1997	1996
Revenues	\$2,295	2,145	958
Costs and expenses	1,993	1,944	866
Operating income	302	201	92
Net interest expense	79	67	29
Income before income taxes and minority interest	223	134	63
Provision for income taxes	111	63	27
Minority interest, net	3	4	—
Income before extraordinary item	109	67	36
Extraordinary loss on extinguishment of debt, net of tax benefit of \$52	—	—	(74)
Income (loss) from discontinued gaming operations	<u>\$ 109</u>	<u>67</u>	<u>(38)</u>

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Hilton Hotels Corporation and its majority owned and controlled subsidiaries. The Company adopted EITF 97-2 "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements" in the fourth quarter of 1998, and, as a result, no longer consolidates the operating results and working capital of affiliates operated under long-term management agreements. Application of EITF 97-2 reduced each of revenues and operating expenses by \$1.3 billion and \$1.6 billion for the years ended December 31, 1997 and 1996, respectively. Application of the standard reduced each of current assets and current liabilities by \$240 million at December 31, 1997. Application of EITF 97-2 had no impact on reported operating income, net income, earnings per share or stockholders' equity.

All material intercompany transactions are eliminated and net earnings are reduced by the portion of the earnings of affiliates applicable to other ownership interests. There are no significant restrictions on the transfer of funds from the Company's wholly owned subsidiaries to Hilton Hotels Corporation.

Cash and Equivalents

Cash and equivalents include investments with initial maturities of three months or less.

Currency Translation

Assets and liabilities denominated in most foreign currencies are translated into U.S. dollars at year-end exchange rates and related gains and losses, net of applicable deferred income taxes, are reflected in stockholders' equity. Gains and losses from foreign currency transactions are included in earnings.

Property and Equipment

Property and equipment are stated at cost. Interest incurred during construction of facilities is capitalized and amortized over the life of the asset. Costs of improvements are capitalized. Costs of normal repairs and maintenance are charged to expense as incurred. Upon the sale or retirement of property and equipment, the cost and related accumulated depreciation are removed from the respective accounts, and the resulting gain or loss, if any, is included in income.

Depreciation is provided on a straight-line basis over the estimated useful life of the assets. Leasehold improvements are amortized over the shorter of the asset life or lease term. The service lives of assets are generally 40 years for buildings and eight years for building improvements and furniture and equipment.

The carrying value of the Company's assets are reviewed when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined that an impairment loss has occurred based on expected future cash flows, then a loss is recognized in the income statement using a fair value based model.

Pre-Opening Costs

Costs associated with the opening of new properties or major additions to properties are deferred and amortized over the shorter of the period benefited or one year. In April 1998, the AICPA issued Statement of Position ("SOP") 98-5, "Reporting on the Costs of Start-Up Activities." This SOP requires that all nongovernmental entities expense costs of start-up activities (pre-opening, pre-operating and organizational costs) as those costs are incurred and requires the write-off of any unamortized balances upon implementation. SOP 98-5 is effective for financial statements issued for periods beginning after December 15, 1998. The Company will adopt SOP 98-5 in the first quarter of 1999. Adoption of the SOP is not expected to have a material impact on the 1999 results of operations.

Unamortized Loan Costs

Debt discount and issuance costs incurred in connection with the placement of long-term debt are capitalized and amortized to interest expense, principally on the bonds outstanding method.

Self-Insurance

The Company is self-insured for various levels of general liability, workers' compensation and employee medical and life insurance coverage. Insurance reserves include the present values of projected settlements for claims.

Earnings Per Share ("EPS")

Basic EPS is computed by dividing net income available to common stockholders (net income less preferred dividends of \$10 million in 1998 and \$13 million in 1997) by the weighted average number of common shares outstanding for the period. The weighted average number of common shares outstanding for 1998, 1997 and 1996 were 250 million, 250 million and 197 million, respectively. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The dilutive effect of the assumed exercise of stock options and convertible securities increased the weighted average number of common shares by 28 million, 31 million and 12 million for 1998, 1997 and 1996, respectively. In addition, the increase to net income resulting from interest on convertible securities assumed to have not been paid was \$15 million, \$15 million and \$9 million for 1998, 1997 and 1996, respectively.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

Reclassifications

The consolidated financial statements for prior years reflect certain reclassifications to conform with classifications adopted in 1998. These classifications have no effect on net income.

notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

INVENTORIES

Included in inventories at December 31, 1998 and 1997 are unsold intervals at the Company's vacation ownership properties of \$42 million and \$32 million, respectively. Inventories are valued at the lower of cost or estimated net realizable value.

INVESTMENTS

Investments at December 31, 1998 and 1997 are as follows:

(in millions)	1998	1997
Equity investments		
Hotels (seven in 1998, eight in 1997)	\$ 33	52
Other	58	41
Vacation ownership notes receivable	107	86
Other notes receivable	40	19
Marketable securities	24	35
Total	<u>\$262</u>	<u>233</u>

PROPERTY AND EQUIPMENT

Property and equipment at December 31, 1998 and 1997 are as follows:

(in millions)	1998	1997
Land	\$ 379	166
Buildings and leasehold improvements	2,296	1,546
Furniture and equipment	540	384
Property held for sale or development	37	39
Construction in progress	71	18
	<u>3,323</u>	<u>2,153</u>
Less accumulated depreciation	840	780
Total	<u>\$2,483</u>	<u>1,373</u>

ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 1998 and 1997 are as follows:

(in millions)	1998	1997
Accounts and notes payable	\$128	87
Accrued compensation and benefits	63	44
Other accrued expenses	219	137
Total	<u>\$410</u>	<u>268</u>

LONG-TERM DEBT

Long-term debt at December 31, 1998 and 1997 is as follows:

(in millions)	1998	1997
Industrial development revenue bonds at adjustable rates, due 2015	\$ 82	82
Senior notes, with an average rate of 7.6%, due 2001 to 2017	1,117	1,174
Senior notes, with an average rate of 7.2%, due 2002 to 2004	625	623
Mortgage notes, 5.9% to 8.4%, due 1999 to 2016	145	116
5% Convertible subordinated notes due 2006	492	491
Commercial paper	—	280
Revolving loans	635	—
Other	3	8
Debt allocated to discontinued gaming operations	—	(1,306)
	<u>3,099</u>	<u>1,468</u>
Less current maturities	62	31
Net long-term debt	<u>\$3,037</u>	<u>1,437</u>

Interest paid, net of amounts capitalized, was \$130 million, \$74 million and \$55 million in 1998, 1997 and 1996, respectively. Capitalized interest amounted to \$4 million and \$2 million in 1998 and 1997, respectively. No interest was capitalized in 1996.

Debt maturities during the next five years are as follows:

(in millions)

1999	\$ 62
2000	53
2001	170
2002	572
2003	483

In order to equalize the indebtedness between Hilton and Park Place at the time of the spin-off, pro forma for the merger of Park Place and Grand, Hilton and Park Place agreed to an allocation of the December 31, 1998 debt balances and entered into a debt assumption agreement. Pursuant to the debt assumption agreement, Park Place assumed and agreed to pay 100% of the amount of each payment required to be made by Hilton under the terms of the indentures governing Hilton's \$300 million 7.375% Senior Notes due 2002 and its \$325 million 7% Senior Notes due 2004. These notes remain in Hilton's long-term debt balance and a long-term receivable from Park Place in an equal amount is included in the Company's 1998 consolidated balance sheet. In the event of an increase in the interest rate on these notes as a result of certain actions taken by Hilton or certain other limited circumstances, Hilton will be required to reimburse Park Place for any such increase. Hilton is obligated to make any payment Park Place fails to make, and in such event Park Place shall pay to Hilton the amount of such payment together with interest, at the rate per annum borne by the applicable notes plus two percent, to the date of such reimbursement.

In order to facilitate the transfer of debt balances in connection with the spin-off, in December 1998 Park Place entered into a long-term credit facility and completed a senior subordinated note offering. Park Place used the proceeds from the new facility and note offering to repay \$1,066 million of Hilton's commercial paper borrowings, representing an estimate of Park Place's share of the obligation. The distribution agreement entered into between Hilton and Park Place calls for a final reconciliation and allocation of certain debt and cash balances, as defined. The reconciliation resulted in an additional amount due Hilton from Park Place of \$73 million. This balance is reflected in current assets in the accompanying consolidated financial statements. A pro rata portion of Hilton's historical outstanding public and corporate bank debt balances and related interest expense has been allocated to Park Place for prior periods.

By virtue of an agreement with Prudential to restructure the joint venture ownership of the Hilton Hawaiian Village, effective June 1, 1998 the Company was deemed to control the joint venture, thus requiring consolidation of this previously unconsolidated entity. The agreement also called for the refinancing of the joint venture's existing debt under a new joint venture revolving credit facility. In accordance with the terms of the agreement, this new facility was used to borrow an additional \$294 million which was loaned to a Prudential affiliate and subsequently redeemed to increase the Company's investment in the joint venture from 50% to 98%. The consolidation of the joint venture, which includes the total borrowings under the new facility, resulted in an increase in consolidated debt of \$480 million.

During 1996, the Company entered into a long-term revolving credit facility with an aggregate commitment of \$1.75 billion, which expires in 2001. At December 31, 1998, \$155 million was outstanding, leaving approximately \$1.6 billion of the revolving credit facility available to the Company at such date. Borrowings will generally bear interest at the London Interbank Offered Rate ("LIBOR") plus a spread based on the Company's public debt rating or a leverage ratio. The all in cost of borrowings under the facility was approximately LIBOR plus 60 basis points as of December 31, 1998.

In October 1997, the Company filed a shelf registration statement ("Shelf") with the Securities and Exchange Commission registering up to \$2.5 billion in debt or equity securities. At December 31, 1998, available financing under the Shelf totaled \$2.1 billion. The terms of any additional securities offered pursuant to the Shelf will be determined by market conditions at the time of issuance.

In accordance with the terms of the indenture governing the Company's \$500 million 5% Convertible Subordinated Notes due 2006, effective January 4, 1999, the conversion price was adjusted to \$22.17, reflecting the gaming spin-off.

Provisions under various loan agreements require the Company to comply with certain financial covenants which include limiting the amount of outstanding indebtedness.

FINANCIAL INSTRUMENTS

Cash Equivalents and Long-Term Marketable Securities

The fair value of cash equivalents and long-term marketable securities is estimated based on the quoted market price of the investments.

notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Long-Term Debt

The estimated fair value of long-term debt is based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities.

The estimated fair values of the Company's financial instruments at December 31, 1998 and 1997 are as follows:

(in millions)	1998		1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and equivalents and long-term marketable securities	\$ 71	71	40	40
Long-term debt (including current maturities)	3,099	3,123	1,468	1,517

INCOME TAXES

The provisions for income taxes for the three years ended December 31 are as follows:

(in millions)	1998	1997	1996
Current			
Federal	\$ 98	168	66
State, foreign and local	31	34	18
	129	202	84
Deferred	7	(78)	(5)
Total	\$136	124	79

During 1998, 1997 and 1996 the Company paid income taxes, including amounts paid on behalf of the discontinued gaming operations, of \$165 million, \$150 million and \$83 million, respectively.

The income tax effects of temporary differences between financial and income tax reporting that gave rise to deferred income tax assets and liabilities at December 31, 1998 and 1997 are as follows:

(in millions)	1998	1997
Deferred tax assets		
Accrued expenses	\$ 2	8
Self-insurance and other reserves	26	29
Benefit plans	23	6
Pre-opening costs	11	—
Foreign tax credit carryovers (expire beginning in 2000)	21	3
Disposition of assets	24	30
Other	4	—
	111	76
Valuation allowance	(3)	(3)
	108	73
Deferred tax liabilities		
Fixed assets, primarily depreciation	(30)	(14)
Equity investments	(80)	(59)
Other	(15)	(5)
	(125)	(78)
Net deferred tax liability	\$ (17)	(5)

The reconciliation of the Federal income tax rate to the Company's effective tax rate is as follows:

	1998	1997	1996
Federal income tax rate	35.0%	35.0	35.0
Increase (reduction) in taxes			
State and local income taxes, net of Federal tax benefits	4.2	4.0	3.9
Foreign taxes, net	—	.4	.3
Spin-off costs	.8	—	—
Other	.5	.1	(.5)
Effective tax rate	40.5%	39.5	38.7

STOCKHOLDERS' EQUITY

Four hundred million shares of common stock with a par value of \$2.50 per share are authorized, of which 265 million and 251 million were issued at December 31, 1998 and 1997, respectively, including treasury shares of four million and two million in 1998 and 1997, respectively. Authorized preferred stock includes 25 million shares of preferred stock with a par value of \$1.00 per share. In October 1998, 15 million shares of 8% PRIDES convertible preferred stock were converted into 14 million shares of common stock. Fifteen million shares of 8% PRIDES were issued and outstanding at December 31, 1997; no preferred shares were issued or outstanding at December 31, 1998.

To reflect the spin-off of the gaming business, the \$3.3 billion book value of net assets of discontinued gaming operations as of December 31, 1998 was charged against the Company's retained earnings and additional paid-in capital.

The Company's Board of Directors has approved the repurchase by the Company of up to 20 million shares of its common stock pursuant to a stock repurchase program. The timing of the stock purchases are made at the discretion of the Company's management. At December 31, 1998, the Company had repurchased 4.3 million shares or 22 percent of the total authorized to be repurchased. The Company may at any time repurchase up to 15.7 million of the remaining shares authorized for repurchase.

The Company has a Share Purchase Rights Plan under which a right is attached to each share of the Company's common stock. The rights may only become exercisable under certain circumstances involving actual or potential acquisitions of the Company's common stock by a specified person or affiliated group. Depending on the circumstances, if the rights become exercisable, the holder may be entitled to purchase units of the Company's junior participating preferred stock, shares of the Company's common stock or shares of common stock of the acquiror. The rights remain in existence until July 2008 unless they are terminated, exercised or redeemed.

The Company applies APB Opinion 25 and related interpretations in accounting for its stock-based compensation plans. Accordingly, compensation expense recognized was different than what would have otherwise been recognized under the fair value based method defined in SFAS No. 123, "Accounting for Stock-Based Compensation." Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards

under those plans consistent with the method of SFAS No. 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below:

(in millions, except per share amounts)	1998	1997	1996
Income from continuing operations	\$ 183	178	116
Discontinued gaming operations	92	61	(41)
Net income	<u>\$ 275</u>	<u>239</u>	<u>75</u>
Basic EPS			
Income from continuing operations	\$.69	.66	.59
Discontinued gaming operations	.37	.25	(.21)
Net income	<u>\$1.06</u>	<u>.91</u>	<u>.38</u>
Diluted EPS			
Income from continuing operations	\$.69	.66	.59
Discontinued gaming operations	.35	.24	(.21)
Net income	<u>\$1.04</u>	<u>.90</u>	<u>.38</u>

At December 31, 1998, 33 million shares of common stock were reserved for the exercise of options under the Company's Stock Incentive Plans. Options may be granted to salaried officers, directors and other key employees of the Company to purchase common stock at not less than the fair market value at the date of grant. Generally, options may be exercised in installments commencing one year after the date of grant. The Stock Incentive Plans also permit the granting of Stock Appreciation Rights ("SARs"). No SARs have been granted as of December 31, 1998.

On December 31, 1998, the effective date of the spin-off, all outstanding options under the Stock Incentive Plans were adjusted to represent options to purchase an equivalent number of shares of Hilton common stock and shares of Park Place common stock. The exercise price for options to purchase Hilton common stock were adjusted based on relative values of Hilton and Park Place common stock at the date the Company's stock began trading on an ex-dividend basis.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 1998, 1997 and 1996, respectively: dividend yield of one percent for each of the three years; expected volatility of 34, 32 and 27 percent; risk-free interest rates of 5.51, 6.49 and 6.33 percent and expected lives of six years for each of the three years.

notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the status of the Company's stock option plans as of December 31, 1998, 1997 and 1996, and changes during the years ending on those dates is presented below:

	Options Price Range (per share)	Weighted Average Price (per share)	Options Outstanding	Available for Grant
Balance at December 31, 1995	\$ 4.68 – 12.16	\$ 8.71	6,825,740	346,504
Authorized			—	12,000,000
Granted	11.88 – 18.70	13.28	9,777,900	(9,777,900)
Exercised	4.68 – 12.16	7.08	(2,135,426)	—
Cancelled	4.72 – 17.15	11.03	(668,758)	653,158
Balance at December 31, 1996	4.68 – 18.70	12.08	13,799,456	3,221,762
Authorized			—	6,200,000
Granted	15.95 – 21.30	16.73	3,046,990	(3,046,990)
Exercised	4.72 – 16.23	9.32	(1,418,185)	—
Cancelled	7.46 – 17.15	13.87	(796,642)	795,892
Balance at December 31, 1997	4.68 – 21.30	13.23	14,631,619	7,170,664
Authorized			—	12,000,000
Granted	12.17 – 27.53	18.23	9,113,850	(9,113,850)
Exercised	4.72 – 18.38	10.04	(692,067)	—
Cancelled	10.48 – 21.30	15.71	(2,359,632)	2,359,632
Balance at December 31, 1998	\$ 4.68 – 27.53	\$15.25	20,693,770	12,416,446

The following table summarizes information about stock options outstanding at December 31, 1998:

Range of Exercise Price	Number Outstanding	Options Outstanding		Number Exercisable	Weighted Average Exercise Price
		Weighted Average Remaining Contractual Life	Weighted Average Exercise Price		
\$ 4.68 – 11.88	7,999,918	2.73	\$11.32	4,867,168	\$10.99
12.51 – 16.59	7,554,652	8.91	14.57	1,321,687	15.41
16.65 – 27.53	5,139,200	9.22	22.39	357,750	17.51
\$ 4.68 – 27.53	20,693,770	6.60	\$15.25	6,546,605	\$12.24

Effective January 1, 1997, the Company adopted the 1997 Employee Stock Purchase Plan by which the Company is authorized to issue up to two million shares of common stock to its full-time employees. Under the terms of the Plan, employees can elect to have a percentage of their earnings withheld to purchase the Company's common stock.

EMPLOYEE BENEFIT PLANS

The Company has a noncontributory retirement plan ("Basic Plan") covering substantially all regular full-time, nonunion employees. The Company also has plans covering qualifying employees and non-officer directors ("Supplemental Plans"). Benefits for all plans are based upon years of service and compensation, as defined.

The Company's funding policy is to contribute not less than the minimum amount required under Federal law but not more than the maximum deductible for Federal income tax purposes. After December 31, 1996, employees will not accrue additional benefits for future service under either the Basic or Supplemental Plans. Plan assets will be used to pay benefits due employees for service through that date.

The following sets forth the funded status for the Basic Plan as of December 31, 1998 and 1997:

(in millions)	1998	1997
Actuarial present value of benefit obligation		
Projected benefit obligation for service rendered to date	\$(225)	(214)
Plan assets at fair value, primarily listed securities and temporary investments	257	242
Projected benefit obligation less than plan assets	32	28
Unrecognized gain	(45)	(41)
Accrued pension cost	\$ (13)	(13)
Pension cost includes the following components		
Interest cost on projected benefit obligation	\$ 15	15
Expected return on plan assets	(15)	(17)
Net periodic pension cost	\$ —	(2)

Included in plan assets at fair value are equity securities of Hilton and Park Place of \$21 million and \$32 million at December 31, 1998 and 1997, respectively.

The following sets forth the funded status for the Supplemental Plans as of December 31, 1998 and 1997:

(in millions)	1998	1997
Actuarial present value of benefit obligation		
Projected benefit obligation for service rendered to date	\$ (8)	(17)
Plan assets at fair value	—	12
Projected benefit obligation in excess of plan assets	(8)	(5)
Unrecognized net loss	4	1
Accrued pension cost	<u>\$ (4)</u>	<u>(4)</u>
Pension cost includes the following components		
Interest cost on projected benefit obligation	\$ 1	1
Expected return on plan assets	(1)	(3)
Net periodic pension cost	<u>\$ —</u>	<u>(2)</u>

The discount rate used in determining the actuarial present values of the projected benefit obligations was 6.75 percent in 1998 and 7 percent in 1997. The expected long-term rate of return on assets is 7.25 percent. The projected benefit obligation and accumulated benefit obligation were \$8 million and \$8 million, respectively, as of December 31, 1998. The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were \$17 million, \$17 million and \$12 million, respectively, as of December 31, 1997.

A significant number of the Company's employees are covered by union sponsored, collectively bargained multi-employer pension plans. The Company contributed and charged to expense \$11 million, \$9 million and \$5 million in 1998, 1997 and 1996, respectively, for such plans. Information from the plans' administrators is not sufficient to permit the Company to determine its share, if any, of unfunded vested benefits.

The Company also has other employee investment plans whereby the Company contributes certain percentages of employee contributions. The cost of these plans is not significant.

POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Company provides life insurance benefits to certain retired employees. Under terms of the plan covering such life insurance benefits, the Company reserves the right to change, modify or discontinue these benefits. The Company does not provide postretirement health care benefits to its employees. The cost of the benefits provided is not significant.

LEASES

The Company operates seven properties under noncancellable operating leases, all of which are for land only, having remaining terms up to 44 years. Upon expiration of three of the leases, the Company has renewal options of 30, 30 and 40 years. Six leases require the payment of additional rentals based on varying percentages of revenue or income. Minimum lease commitments under noncancelable operating leases approximate \$13 million annually through 2003 with an aggregate commitment of \$215 million through 2042.

COMMITMENTS AND CONTINGENCIES

At December 31, 1998, the Company had contractual commitments at its wholly owned or leased properties for major expansion and rehabilitation projects of approximately \$130 million.

Various lawsuits are pending against the Company. In management's opinion, disposition of these lawsuits is not expected to have a material effect on the Company's financial position or results of operations.

report of independent public accountants

To the Board of Directors and

Stockholders of Hilton Hotels Corporation:

We have audited the accompanying consolidated balance sheets of Hilton Hotels Corporation (a Delaware corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting

the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hilton Hotels Corporation and subsidiaries as of December 31, 1998 and 1997 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Arthur Andersen LLP

Los Angeles, California

February 5, 1999

supplementary financial information

(unaudited)

QUARTERLY FINANCIAL DATA

(dollars in millions, except per share amounts)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
1998					
Revenue	\$366	457	450	496	1,769
EBITDA ⁽¹⁾	122	173	150	151	596
Operating income	94	142	116	112	464
Income from continuing operations	38	65	41	44	188
Income from discontinued gaming operations	39	41	38	(9)	109
Net income	77	106	79	35	297
Basic EPS ⁽²⁾					
Continuing operations	\$.14	.25	.15	.17	.71
Discontinued gaming operations	.16	.16	.16	(.03)	.44
Net income	<u>\$.30</u>	<u>.41</u>	<u>.31</u>	<u>.14</u>	<u>1.15</u>
Diluted EPS					
Continuing operations	\$.14	.25	.15	.17	.71
Discontinued gaming operations	.15	.14	.15	(.03)	.41
Net income	<u>\$.29</u>	<u>.39</u>	<u>.30</u>	<u>.14</u>	<u>1.12</u>
1997					
Revenue	\$321	399	369	386	1,475
EBITDA ⁽¹⁾	103	154	129	111	497
Operating income	76	131	105	83	395
Income from continuing operations	31	67	44	41	183
Income from discontinued gaming operations	37	26	50	(46)	67
Net income	68	93	94	(5)	250
Basic EPS					
Continuing operations	\$.11	.26	.16	.15	.68
Discontinued gaming operations	.15	.10	.20	(.18)	.27
Net income	<u>\$.26</u>	<u>.36</u>	<u>.36</u>	<u>(.03)</u>	<u>.95</u>
Diluted EPS ⁽²⁾					
Continuing operations	\$.11	.25	.16	.15	.68
Discontinued gaming operations	.15	.09	.19	(.18)	.26
Net income	<u>\$.26</u>	<u>.34</u>	<u>.35</u>	<u>(.03)</u>	<u>.94</u>

As of December 31, 1998 there were approximately 15,200 stockholders of record.

⁽¹⁾ EBITDA is earnings before interest, taxes, depreciation, amortization and non-cash items. Non-cash items, such as asset write-downs and impairment losses, are excluded from EBITDA as these items do not impact operating results on a recurring basis. This information should not be considered as an alternative to any measure of performance as promulgated under generally accepted accounting principles (such as operating income or net income), nor should it be considered as an indicator of the overall financial performance of the Company. The Company's calculation of EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

⁽²⁾ The sum of EPS for the four quarters may differ from the annual EPS due to the required method of computing weighted average number of shares in the respective periods.

supplementary financial information

(unaudited)

EBITDA ⁽¹⁾

(in millions)

Year Ended December 31, 1998

1997

1996

EBITDA

Operations

\$ 660

561

401

Corporate expense, net

(64)

(64)

(40)

Total EBITDA

\$ 596

497

361

Reconciliation to income from continuing operations:

EBITDA

\$ 596

497

361

Interest and dividend income

13

17

26

Interest expense

(137)

(90)

(52)

Interest expense, net, from unconsolidated affiliates

(4)

(8)

(7)

Depreciation and amortization ⁽²⁾

(132)

(104)

(102)

Non-cash items

—

2

(22)

Provision for income taxes

(136)

(124)

(79)

Minority interest, net

(12)

(7)

(5)

Income from continuing operations

\$ 188

183

120

⁽¹⁾ EBITDA is earnings before interest, taxes, depreciation, amortization and non-cash items. Non-cash items, such as asset write-downs and impairment losses, are excluded from EBITDA as these items do not impact operating results on a recurring basis. This information should not be considered as an alternative to any measure of performance as promulgated under generally accepted accounting principles (such as operating income or net income), nor should it be considered as an indicator of the overall financial performance of the Company. The Company's calculation of EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

⁽²⁾ Includes proportionate share of unconsolidated affiliates.

five year summary

(unaudited)

(dollars in millions, except per share, average rate and RevPAR amounts)	Year Ended December 31, 1998	1997	1996	1995	1994
OPERATING DATA					
Revenue	\$ 1,769	1,475	947	715	622
EBITDA⁽¹⁾					
Operations	\$ 660	561	401	308	244
Corporate expense, net	(64)	(64)	(40)	(18)	(20)
Total	\$ 596	497	361	290	224
BASIC EARNINGS PER SHARE					
Income from continuing operations	\$.71	.68	.61	.46	.22
Discontinued gaming operations	.44	.27	(.20)	.44	.42
Net income	\$ 1.15	.95	.41	.90	.64
DILUTED EARNINGS PER SHARE					
Income from continuing operations	\$.71	.68	.61	.45	.22
Discontinued gaming operations	.41	.26	(.20)	.44	.41
Net income	\$ 1.12	.94	.41	.89	.63
GENERAL INFORMATION					
Occupancy⁽²⁾	73.4%	75.8	75.5	73.4	70.1
Average rate⁽²⁾	\$157.51	146.00	134.59	125.79	120.88
RevPAR⁽²⁾	\$115.64	110.61	101.67	92.29	84.69
Number of properties at year end					
Owned or partially owned hotels	37	32	31	33	33
Managed hotels	24	27	28	24	24
Franchised hotels	188	180	172	162	161
Total	249	239	231	219	218
Available rooms at year end					
Owned or partially owned hotels	25,762	23,799	23,092	24,098	24,098
Managed hotels	14,690	15,779	16,776	15,096	15,686
Franchised hotels	46,562	45,092	43,694	41,687	40,436
Total	87,014	84,670	83,562	80,881	80,220

⁽¹⁾ EBITDA is earnings before interest, taxes, depreciation, amortization and non-cash items. Non-cash items, such as asset write-downs and impairment losses, are excluded from EBITDA as these items do not impact operating results on a recurring basis. This information should not be considered as an alternative to any measure of performance as promulgated under generally accepted accounting principles (such as operating income or net income), nor should it be considered as an indicator of the overall financial performance of the Company. The Company's calculation of EBITDA may be different from the calculation used by other companies and therefore comparability may be limited.

⁽²⁾ Comparable domestic owned and managed properties.

board of directors

BOARD OF DIRECTORS

Stephen F. Bollenbach^(3,4)

President and Chief Executive Officer

A. Steven Crown^(1,2,5)

General Partner, Henry Crown & Company, Chicago, Illinois – Diversified manufacturing operations, marine operations and real estate ventures

Peter M. George^(1,2,3)

Vice Chairman and Group Chief Executive – Ladbroke Group PLC, and Chairman – Hilton International Co., Herts, England – Hotel and gaming company

Arthur M. Goldberg

President and Chief Executive Officer, Park Place Entertainment Corporation Las Vegas, Nevada – Casino gaming company

Barron Hilton⁽⁵⁾

Chairman

Dieter H. Huckestein

Executive Vice President, Hilton Hotels Corporation, and President – Hotel Operations

Robert L. Johnson^(1,2,4,5)

Chairman and Chief Executive Officer, BET Holdings, Inc., Washington, D.C. – Diversified media holding company, Chairman and President of District Cablevision, Inc.

Donald R. Knab^(1,2,3,5)

Ponte Vedra Beach, Florida – Investment advisor

Benjamin V. Lambert^(1,3,5)

Chairman and Chief Executive Officer, Eastdil Realty Company, L.L.C., New York – Real estate investment bankers

Donna F. Tuttle^(1,2,3,4)

President, Korn Tuttle Capital Group, Los Angeles, California – Financial consulting and investments firm

Sam D. Young, Jr.^(1,2)

Chairman, Trans-West Enterprises, Inc., El Paso, Texas – Investments

⁽¹⁾Members of the Audit Committee

⁽²⁾Members of the Personnel and Compensation Committee

⁽³⁾Members of the Nominating Committee

⁽⁴⁾Members of the Diversity Committee

⁽⁵⁾Members of the Compliance Committee

CORPORATE EXECUTIVE OFFICERS

Barron Hilton

Chairman

Stephen F. Bollenbach

President and Chief Executive Officer

Thomas E. Gallagher

Executive Vice President, General Counsel and Secretary

Matthew J. Hart

Executive Vice President, Chief Financial Officer and Treasurer

Dieter H. Huckestein

Executive Vice President, Hilton Hotels Corporation, and President – Hotel Operations

CORPORATE SENIOR OFFICERS

James M. Anderson

Senior Vice President – Labor Relations and Personnel Administration

Marc A. Grossman

Senior Vice President – Corporate Affairs

Robert M. La Forgia

Senior Vice President and Controller

Ted Middleton, Jr.

Senior Vice President – Development and Finance

Dorothy J. Porter

Senior Vice President – Diversity

Patrick B. Terwilliger

Senior Vice President – Architecture and Construction

CORPORATE INFORMATION

Hilton Hotels Corporation

*World Headquarters
9336 Civic Center Drive
Beverly Hills, California 90210
310.278.4321*

**Transfer Agent and Registrar
for Common Stock**

*ChaseMellon
Shareholder Services, L.L.C.
85 Challenger Road
Overpeck Centre
Ridgefield Park, New Jersey 07660
www.chasemellon.com
1.888.224.2751*

Independent Public Accountants

Arthur Andersen LLP

Form 10-K

Stockholders wishing to receive a copy of the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, exclusive of the exhibits thereto, may do so without charge by writing to Investor Relations, Hilton Hotels Corporation, 9336 Civic Center Drive, Beverly Hills, California 90210.

Annual Meeting

The annual meeting of stockholders is scheduled to be held at the Hilton Beverly Hills, 9876 Wilshire Boulevard, Beverly Hills, California, on May 12, 1999 at 10:00 a.m.

Hotel Reservation Information

1.800.HILTONS

Visit our website at:

<http://www.hilton.com>

