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Panel on Economic Development
Follow-up to the Special Meeting on 30 June 2009

Update on Proposed Expansion of Hong Kong Disneyland

The note sets out the supplementary information requested by Members during the discussion on the captioned subject at the special meeting of the Panel on Economic Development on 30 June 2009.

Management Fee

2. The objective of the new formula for calculating the base management fee[1] is to link the management fee payable to the management company to the actual park performance; in other words, the better the park's performance, the more will the base management fee be, and vice versa.

3. It is not appropriate to directly compare the amount of base management fee payable to the management company under the original (2% of gross revenue) and new formulae (6.5% of EBITDA) as TWDC had agreed to waive the management fee for 2007-08. But if we were to compare the actual amount received by the management company in the past three years and the amount which it could receive under the new formula, the latter would be about 90% less.

4. Looking at the years from 2009-10 to 2044-45, on average the effective rate of base management fee payable under both the new and old formulae would be about the same if the park can achieve the business performance projected by TWDC under "Case 1A". Under the more conservative projections of "Case 1B", on average the effective rate of the base management fee payable under the new formula would be about 30% less than that payable under the existing formula.

[1] The agreement reached between Government and TWDC in 1999 also provided for a variable management fee with the rate of 2-8% of EBITDA. Under the new arrangement, the rate will be revised to 0-8% of EBITDA.

Government investment in the Hong Kong Disneyland (HKD) project and financial performance of the joint-venture

5. In 1999, Government contributed $3.25 billion as equity and $5.62 billion as loan to Hongkong International Theme Parks Limited (HKITP). As at mid July 2009, taking account of the capitalised and deferred interest of $1.27 billion, the outstanding balance of the Government loan is estimated to be $6.89 billion.

6. Government's total spending on the reclamation of the Phase 1 site, associated infrastructure and provision of government, institution and community facilities amounted to $10.57 billion. This figure is lower than the $13.6 billion approved by the Finance Committee (FC) in November 1999, mainly because of an overall reduction ($1.65 billion) in the project cost, and the removal of the reclamation cost of the Phase 2 site ($1.38 billion). Government received $4 billion in subordinated shares, representing the land premium of the Phase 1 site.

7. Government paid a land acquisition and clearance cost of $1.506 billion for the purpose of acquiring about 18.7 hectares of land by voluntary surrender of a shipyard site.

8. To support the construction and operation of the Disneyland Resort Line, Government also waived its claim of $798 million (in 2002 present value) in dividend that would otherwise be payable to Government by MTRC to bridge the funding gap identified for the railway.

9. Both Government and TWDC are bound by the confidentiality provision under the current agreement not to disclose any commercially sensitive information including the gain or loss from the operation of HKD thus far. That said, Government and TWDC have agreed to disclose the park's annual attendance and key indicators of its financial performance from the operation year of 2008-09. The disclosure would allow a better understanding of the park's performance.

Conversion of subordinated shares to ordinary shares

10. Back in 1999, Government and TWDC agreed, and FC approved, that the $4 billion subordinated shares would be converted to ordinary shares progressively during the life of the HKD project to the extent that the park's

operating performance exceeded the then projected “Base Case”.

11. Both sides also agreed in 1999 that the $4 billion subordinated shares would be converted in a gradual manner, to ensure that the benefits of the ordinary shares held by other investors would not be diluted substantially within a short period of time, and that the conversion would only begin after five years of HKD operation to allow for fluctuation in business in the early operating years. The permitted conversion ceiling would thereafter rise by 5% per annum cumulatively, thus rendering full conversion of the subordinated shares within 25 years after park opening possible if the park’s business performance can consistently exceed the projections at the time. In order to prevent excessive equity dilution in any one year, an annual cap of 10% on conversion was further agreed.

12. Under the in-principle agreement reached between Government and TWDC, the above mechanism governing the progressive conversion of subordinated shares will remain unchanged. The performance benchmark for conversion of subordinated shares will be updated after the expansion to reflect TWDC’s current projections under “Case 1A”. Whether the subordinated shares can be converted to ordinary shares would depend on the park’s future business performance.

Interest on the Government loan and Government’s share of the dividends on equity in HKITP

13. Although interest would in theory be payable if Government does not convert its loan to HKITP into equity (the current interest rate is set at 3.34%), we must emphasise that the conversion of both the TWDC and Government loans to equity is part and parcel of the capital realignment and expansion plan for HKD to ensure that the debt level of HKITP is substantially reduced, to preserve cash for the park’s operation and expansion, and to maintain Government’s position as the majority shareholder of HKITP (under current projections). It would therefore be purely hypothetical to try to compare the estimated amount of interest on the outstanding balance of the Government loan assuming no part of the balance would be converted to equity (“no conversion scenario”), and the estimated amount of dividends on the increased equity after the proposed loan-to-equity conversion (“conversion scenario”).

14. On this hypothetical basis, from 2009-10 to 2044-45, under “Case 1A”, the projected aggregate amount of interest and dividend to be received by

Government would be higher in the "loan conversion scenario" than the "no conversion scenario", by about $7.82 billion. Under "Case 1B", the projected aggregate amount of interest and dividends to be receivable by Government would be lower in the "loan conversion scenario" than the "no conversion scenario", by about $1.36 billion.

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