Panel on Economic Development
Follow-up to the special meeting on 4 July 2009

Proposed expansion of Hong Kong Disneyland

This 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 4 July 2009.

Government investment and capital expenditure on the Hong Kong Disneyland (HKD) project

2. The discrepancies between the figures on Government investment and capital expenditure on the HKD project quoted in CB(1)2144/08-09(02) and FS28/08-09 are explained in Enclosure I.

Financial arrangements for other Disney theme parks

3. As part of the due diligence process, our financial adviser has reviewed the information available on financial arrangements relating to the Disney theme parks in Paris and Tokyo. The financial arrangements for individual Disney theme parks are determined by circumstances specific to the respective parks. The capital structure of the Disney theme parks in Tokyo, Paris and Hong Kong are entirely different. Tokyo Disneyland is not managed by The Walt Disney Company (TWDC) or its affiliate and is therefore not charged management fees by TWDC. The base management fee payable to TWDC by Euro Disney (owner of Disneyland Paris) is linked to the park's gross revenue. The rates for royalties are similar among all three Disney theme parks.

Disclosure of information

4. On HKD's operating and financial results in the past three years, as indicated in CB(1)2144/08-09(02), Government and The Walt Disney Company (TWDC) are both bound by the confidentiality provision under the relevant agreement; such information cannot be disclosed without consent by both parties.

5. Notwithstanding the above, Government and TWDC have agreed to publish an annual business review, starting with the operation year of 2008-09, that would disclose the following items:

Business indicators (for both the current and the immediately prior financial year, unless otherwise specified)

- *Attractions and guest offerings opened/launched in the relevant financial year*

- *Guest satisfaction for overall theme park and hotel experience*
- *Total annual park attendance*
- *Increase/(decrease) in park attendance (indicate as a % change)*
- *Increase/(decrease) in per capita park guest spending (indicate as a % change)*
- *Hotel occupancy (indicate as a %)*
- *Increase/(decrease) in available hotel room nights (indicate as a % change)*
- *Increase/(decrease) in per hotel room guest spending (indicate as a % change)*
- *Percentage of visitors by place of origin (Local/China/International)*
- *Number of full-time and part-time staff employed during the financial year*

Aggregate financial indicators (for both the current and the immediately prior financial year) in HK$ millions

- *Revenues*
- *Costs and expenses*
- *Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)*
- *Depreciation and amortisation*
- *Net finance costs*
- *Net profit/(loss)*
- *Non-current assets*
- *Current assets*
- *Non-current liabilities*
- *Current liabilities*
- *Net Assets/Liabilities*
- *Cash provided (used) by*
    - *Operating activities*
    - *Investing activities*
    - *Financing activities*
- *Net increase/(decrease) in cash*

The annual disclosure would allow a better understanding of HKD's operating and financial performance from 2008-09 onwards. In the disclosure in respect of 2008-09, the 2007-08 figures will also be shown for comparison and reference.

6. As regards the operating and financial results of the expanded HKD, TWDC's projections in respect of "Case 1A" and "Case 1B"[Note 1] are as follows –

"Case 1A"

$ Billion	***2014-15***	***2024-25***	***2034-35***	***2044-45***
Attendance (million)	8.356	11.000	11.000	11.000
Revenue	5.2	9.3	13.4	18.4
Expenses	(4.2)	(6.4)	(9.0)	(12.4)

EBITDA	1.0	2.9	4.4	6.0
Depreciation and amortisation	(0.9)	(1.6)	(1.5)	(1.6)
Operating income	0.1	1.3	2.9	4.4

<u>"Case 1B"</u>

$ Billion	***2014-15***	***2024-25***	***2034-35***	***2044-45***
Attendance [Note 2] (million)	7.924	9.120	9.194	9.194
Revenue	4.9	6.9	9.2	12.6
Expenses	(4.1)	(5.4)	(7.3)	(10.1)
EBITDA	0.8	1.5	1.9	2.5
Depreciation and amortisation	(0.9)	(1.2)	(1.5)	(1.6)
Operating income	(0.1)	0.3	0.4	0.9

Note 1 : *According to TWDC, the above projections represent estimates and assumptions made in light of the currently available information. Actual results may differ from the projections presented.*

Note 2 : *In developing the long-term projections for "Case 1B", TWDC used a simplifying approach, assuming that the park attendance would reach a certain level by 2025-26 and remain flat thereafter.*

7. It is projected that under "Case 1A", Government will achieve breakeven on the initial equity and new equity from loan conversion by 2029-30. Under "Case 1B", the projected breakeven point is around 2044-45.

8. To facilitate LegCo Members' consideration of the financial proposal relating to the HKD expansion, Government will continue to provide the necessary information insofar as permitted under the agreement with TWDC.

Calculation of management fee

9. As we have stated in CB(1) 2090/08-09(01) and explained at the ED Panel meetings on 30 June and 4 July 2009, it should be noted from the outset that the new formula for calculating the base management fee payable to the management company is part and parcel of a package deal agreed between Government and TWDC. All elements of the package deal have to be considered in its entirety and cannot be individually revised without running the risk of re-opening the negotiation and jeopardising the other agreed elements.

10. The agreement reached between Government and TWDC is to revise the formula for the base management fee from 2% of gross revenue to 6.5% of EBITDA. Government considers this change a significant improvement over the present arrangement which will align the interests of all parties in the joint-venture.

The revised formula will link the payment of the base management fee to the park's financial performance and provide for a reduced fee should performance be impaired.

Depreciation and amortization

11. HKITP calculates depreciation and amortisation in accordance with the respective parts of the Hong Kong Financial Reporting Standards, upon which HKITP's audited financial statements are presented.

12. Depreciation of property, plant and equipment (PP&E) is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives, as follows:

Buildings and improvements	3-40 years
Furniture, fixtures & equipment	3-10 years
Machinery & equipment	3-40 years
Rides & amusements	8-25 years
Shows & parades	5 year

Leasehold land is amortised on a straight-line basis over the remaining lease term commencing from the operation of the park.

Supervision of park performance by Board of Directors of Hongkong International Theme Parks Limited (HKITP)

13. The Board of Directors of HKITP currently comprises two independent non-executive directors (INEDs), Mr Philip Chen and Mr Payson Cha who have extensive commercial experience and expertise, in addition to the five and four directors nominated respectively by Government and TWDC as shareholders. Both shareholders value the contribution made by the INEDs and believe that the present board composition is appropriate.

Economic benefits

<u>Economic benefits brought by HKD in the past three operation years (2005-06 to 2007-08)</u>

14. In the past three operation years, total attendance at HKD was about 13.8 million, of which about 8.6 million or three-fifths were tourists, and about 5.2 million or two-fifths were local visitors. Based on Hong Kong Tourism Board (HKTB)'s survey data, among the tourists to HKD, almost 2 million were induced

tourists, with the rest being base tourists. The induced tourists on average stayed for 2.8 nights and the base tourists on average extended their stay by 0.7 night. Based on survey data on tourist spending compiled by HKTB, additional spending in Hong Kong from tourists visiting HKD was calculated at about HK$16 billion in these three years taken together. The boost to tourist spending was about 5 percentage points each year. Together with the additional spending of local visitors, total additional spending in Hong Kong of all visitors to HKD amounted to about HK$17 billion in the past three operating years.

15. The gross economic benefits or value added stemming from these additional spending are calculated in accordance with the specific operating cost structure of the sectors concerned. This value added comprises direct value added and indirect value added. Direct value added represents the gains of the respective business establishments and employment income for the workforce involved, generated initially from additional spending of the HKD visitors in Hong Kong. The sectors of economic activity concerned are the theme park operation itself, as well as the retail, hotel, restaurant, transport and other tourism-related industries in the territory, and the local airlines. Indirect value added refers to the incomes generated from subsequent rounds of indirect spending on the further range of economic activities in support of these tourism-related sectors. Taking into account both the direct and indirect value added generated from the additional spending of all visitors to HKD, the theme park has brought about HK$10 billion of value added to the Hong Kong economy in the past three operation years. This has raised the GDP by an average of 0.2% each year. The additional spending of visitors to HKD has created more than 10 000 jobs in terms of man-years in the economy in each of the past three years, with considerable job opportunities for workers in the lower segment.

Summary of the results in the past three operation years (2005-06 to 2007-08):

Attendance	About 13.8 million
Average additional length of stay of base tourists	0.7 night
Average length of stay of induced tourists	2.8 nights
Additional spending of tourists to HKDL	About HK$16 billion
Additional spending of all visitors to HKDL	About HK$17 billion
Value added brought to the Hong Kong economy	About HK$10 billion *(raising GDP by an average of 0.2% each year)*

<u>Further explanation on the difference in the economic assessment of the expanded HKD project and attendance projections made by TWDC (“Case 1A” and “Case 1B”) and Government (“Case 2”)</u>

16. Long-term economic assessment of this nature is inevitably subject to

a range of uncertainties, and projections made by different parties could be widely different. The attendance projections adopted in “Case 1A” and “Case 1B” were provided by TWDC. TWDC indicated that their attendance projection is from a micro and bottom-up approach, assessing the size, consumption power and growth potential of each of the major markets to project the penetration rates for individual markets and then aggregating them up to derive the overall attendance projections. The attendance projection in “Case 1B” is obtained under TWDC’s assessment of a slower tourism growth. According to TWDC, they have taken into account a number of factors in projecting the attendance, particularly the anticipated growth in competition in Asia, whether from other theme parks or the broader travel and leisure sector. On the potential Disneyland in Shanghai, TWDC has differentiated the penetration rates of non-Guangdong tourists from those of Guangdong tourists in assessing the trend in the market penetration rate for the mainland market.

17. The projected penetration rates under the three cases above are set out in Annex C to CB(1)2090/08-09(01) and repeated in Enclosure II. Generally speaking, the projected penetration rates under “Case 1A” and “Case 1B” are higher than those in “Case 2”, because TWDC expects that the new themed areas would increase the attractiveness of HKD, and they make higher projection for penetration rates of both tourists and locals. On the other hand, “Case 2” which is the Government’s independent projection, has adopted a more conservative approach in assuming a lower penetration rate to take into account factors including intense competition within the region and an aging population.

18. More importantly, despite the rather substantial difference in attendance projections under the three cases, the economic assessment is that the expanded HKD project could still bring substantial economic benefits to Hong Kong even under the more conservative scenario, i.e. “Case 2”.

Tourism Commission
July 2009

Enclosure I

Government Investment and Capital Expenditure on Hong Kong Disneyland Project

Item	***FS28/08-09***	***CB(1)2144/ 08-09(02)***	***Remarks***
Capital Investment Fund (CIF)			
Equity in HKITP	$3.25 billion	$3.25 billion	
Loan to HKITP	$5.6 billion	$5.62 billion	Upon approval by the Finance Committee (FC) in November 1999, Government provided $5.619 billion from CIF as a loan to HKITP. The outstanding balance of the Government loan, including capitalised and deferred interest, is projected to be $6.89 billion as at mid July 2009.
Subordinated equity in HKITP	$4 billion	$4 billion	Government received $4 billion in subordinated shares in HKITP, representing the land premium of the Phase 1 site. The amount was the estimated pro rata cost of Phase 1 reclamation and formation. The subordinated shares were credited to CIF from which no actual expenditure on site reclamation or formation was made. (The actual cost was charged under the Capital Works Reserve Fund (see below).)
Capital Works Reserve Fund (CWRF)			
Reclamation and infrastructure works	$13.6 billion	$10.57 billion	While FC approved $13.6 billion for land reclamation and infrastructure works, the latest cost was $11.95 billion, reflecting an overall cost reduction of $1.65 billion. From the latest cost of $11.95 billion, the reclamation cost of the Phase 2 site of $1.38 billion is removed to arrive at the figure of $10.57 billion.
Land acquisition	$1.6 billion	$1.506 billion	Government acquired about 18.7 hectares of land by voluntary surrender of a shipyard site, and paid the land acquisition and clearance cost at $1.506 billion.
Others			
Waived cash dividends receivable from MTR Corporation Limited (MTRCL)	$931 million	$798 million	To support the construction and operation of the Disneyland Resort Line, Government waived its claim of cash dividends that would otherwise be payable to Government by MTRCL to bridge the funding gap for the railway project. The figure of $798 million was quoted in 2002 present value, whereas $931 million is the actual amount of dividends waived at different times during 2002-03 to 2004-05.

Enclosure II

Projected Market Penetration Rates

	Case 1A [a]	Case 1B [a]	Case 2
	(2008-09 to 2025-26)		(2008-09 to 2044-45)
Market penetration rate [b]			
Base tourists	7.6% to 11.7% [c]	7.5% to 12.0% [c]	6.0% to 8.7% [e]
Induced tourists	3.6% to 5.2% [c]	3.6% to 5.3% [c]	1.8% to 2.7% [f]
Locals	25.2% to 27.5% [d]	25.2% to 27.4% [d]	21.2% to 25.4% [d]

Notes:

(a) TWDC does not provide market penetration rates for years beyond FY 2026.

(b) Projected from the demand side. Capacity constraint of the theme park has not yet been taken into account.

(c) Figures refer to the respective proportion of *total* tourists to Hong Kong that would visit HKDL.

(d) Figures refer to the proportion of local population that would visit HKDL.

(e) Figures refer to the proportion of base leisure tourists out of total leisure tourists to Hong Kong that would visit HKDL.

(f) Figures refer to the respective proportion of inducted tourists out of total leisure tourists to Hong Kong that would visit HKDL.