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Panel on Economic Development
Meeting on 25 February 2013

Background brief on Hong Kong Disneyland

Purpose

This paper provides an update on the background information of the Hong Kong Disneyland ("HKD") project, its operation since opening in 2005 and the expansion plan. It also summarizes major concerns and views of Members on related issues.

Background

Development of HKD

2. In December 1999, the Government entered into an agreement with The Walt Disney Company ("WD") to build HKD (Phase 1) at Penny's Bay¹. A joint venture company, the Hongkong International Theme Parks Limited ("HKITP"), was set up for this purpose². The then estimated total project cost of developing HKD Phase 1 was \$14.1 billion, in addition to an estimated cost of \$4 billion for reclaiming the land for Phase 1 of the project. The Government and WD had entered into five main agreements covering management, licensing of intellectual property, rights and obligations of shareholders, loan arrangements as well as the parties' responsibilities and undertakings for the development of HKD. The related financial and

¹ The agreement anticipates a Phase 2 project, which will include a second Disney theme park, additional hotels and an expansion of the retail, dining and entertainment complex. Accordingly, the Hongkong International Theme Parks Limited is given an Option to buy the site immediately to the east of the Phase 1 Site for development of the second phase.

² Under the agreement, the Government owns 57% of the shares in HKITP while WD owns 43%. HKITP operates under the supervision of a Board of Directors, which comprises five Government directors, four Disney directors and two independent non-executive directors.

staffing proposals were considered by the former Panel on Economic Services³ at the meetings on 11 and 15 November 1999, and endorsed by the Public Works Subcommittee and approved by the Finance Committee ("FC") on 17 and 26 November 1999 respectively.

Expansion plan

3. To realize the benefits of the long-term investment in HKD, the Government and WD reached agreement in July 2009 for the expansion plan. Under the relevant financial arrangements, WD would contribute all the necessary new capital as equity for the construction of the new attractions as well as sustaining the park's operation during the construction years, and convert the entire outstanding balance of the WD loan (i.e. \$2.76 billion)⁴ to equity. Although the Government would not inject any new capital for the expansion, it would convert its loan to equity after retaining a balance of not less than \$1 billion. Upon the capital injection by WD and conversion of the Government and WD loans, the Government would continue to be a majority shareholder of HKITP with ownership of about 52%⁵. The financial arrangements for the expansion of HKD were approved by FC at the meeting on 10 July 2009.

4. Pursuant to the expansion plan agreement, the formula for calculating the base management fee⁶ has been revised for it to link to HKITP's performance, i.e. to replace the current formula of 2% of gross revenue by 6.5% of earnings before interest, tax, depreciation and amortization ("EBITDA"). A mechanism has been put in place such that payment of royalties to WD's related company/licensor by HKITP will be deferred in the event that HKD's financial performance is hampered by adversity. WD has agreed to make annual disclosure of the main operating and financial results of HKD for both the current and the immediately prior financial years. A list of indicators to be disclosed is in the **Appendix**.

³ The Panel on Economic Services was renamed as the Panel on Economic Development with effect from the 2007-2008 session.

⁴ Following FC's approval in November 1999, the Government and WD provided \$3.25 billion and \$2.45 billion respectively as equity to establish the HKITP. In addition to the equity injection, the Government provided approximately \$5.62 billion as a loan to HKITP, and received \$4 billion in subordinated equity, representing the land premium for the Phase 1 site. HKITP obtained a commercial term loan of \$2.3 billion and a revolving credit facility of \$1 billion in 2000. In September 2008, the shareholders reached agreement to replace the loan and revolving credit facility by a loan from a subsidiary company of WD. The outstanding amount of the WD loan was \$2.76 billion in 2012.

⁵ The Government's shares in HKITP will be lowered from 57% to 52% under the expansion plan.

⁶ The agreement reached between Government and WD 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.

5. The expansion proposal comprised three new themed areas⁷. The first and second new themed areas, Toy Story Land and Grizzly Gulch, were opened in 2011 and 2012 respectively. The remaining third new themed area is scheduled to be completed in 2013.

Operating and financial performance

6. According to the Administration's assessment made in 1999, HKD would generate huge economic benefits for the Hong Kong economy, estimated to reach \$148 billion over 40 years⁸. The accumulated numbers of visitors received by HKD since its opening on 12 September 2005 are set out below –

Year⁹	Accumulated number of attendance
2005-2006	5.2 million
2006-2007	9.2 million
2007-2008 (as at end of November 2008)	14.5 million
2008-2009 (as at end of December 2009)	19 million
2009-2010 (as at end of December 2010)	25 million
2010-2011 (as at end of December 2011)	31 million

The two hotels at HKD recorded a combined occupancy rate of 91% in 2010-2011, representing an increase of 9% from 2009-2010.

⁷ The Government and WD agreed that two of the new themed areas, i.e. "Grizzly Gulch" and "Mystic Point", would be exclusive amongst Disney theme parks worldwide and the remaining one, i.e. "Toy Story Land", would be exclusive amongst Disney theme parks within the Asian region for five years after their respective openings.

⁸ The economic benefits of \$148 billion over 40 years were calculated on the "base case" scenario developed in 1999. Under the "base case" scenario, it was estimated that HKD would attract an attendance of 5.2 million in its first year of operation and such attendance would rise steadily thereafter to 5.47 million in 2006 and 10.57 million in 2044. At the meeting of the former Panel on Economic Services on 29 July 2002, members were informed that WD considered the base case forecast conducted in 1999 too conservative and had therefore revised the attendance figure for the first year upward to 5.6 million.

⁹ Each year of operation of HKD starts in October and ends in the next September unless specified.

7. To support HKITP, WD has waived the management fees and deferred payment of royalties for two years (i.e. 2007-2008 and 2008-2009). As at the end of 2007, HKD has also negotiated with commercial lenders to re-schedule its commercial term loan facility and the revolving credit facility with a view to reducing interest expenses. In September 2008, an agreement was reached between the Government and WD, under which the latter loaned \$3.26 billion (consisting of a term loan and revolving credit facility) to HKITP. The loan was used mainly to repay the HKITP's commercial loan.

8. As regards financial performance in 2010-2011, HKD generated \$3.63 billion of revenue which was about 20% higher than the previous year. The EBITDA was \$506 million, an improvement of \$285 million from \$221 million in 2009-2010. Net finance costs decreased by 58% from \$106 million to \$44 million due to the conversion of part of the loan from Government to ordinary shares following the approval of the FC in July 2009 and the increase in interest capitalized for expansion projects. This resulted in a \$481 million improvement in net loss from \$718 million in 2009-2010 to \$237 million in 2010-2011. With the conversion of part of the loan from Government to ordinary shares and the capital injection from WD, which was partially offset by current year's net loss, shareholders' equity increased from \$9.75 billion to \$11.899 billion in 2010-2011.

Economic benefits

9. According to the survey statistics from Hong Kong Tourism Board ("HKTB") and the operational data of HKD, the additional spending of all HKD visitors in Hong Kong surged by 14% from \$9.6 billion in 2009-2010 to \$10.9 billion in 2010-2011. HKD brought about \$6.7 billion of direct and indirect value added to Hong Kong in 2010-2011, equivalent to around 0.4% of the Gross Domestic Product ("GDP"), and created 20 800 jobs (in terms of man-year). Taking the first six years of operation together, the total value added generated by HKD since opening amounted to \$27.3 billion or 0.3% of GDP. A total of 84 500 jobs (in terms of man-year) had been created over these years, providing considerable job opportunities especially for grassroot workers and the travel industry.

Staffing

10. In 2010-2011, HKD's full time workforce was approximately 4 500. It also engaged 1 700 part-time staff to cope with the increased demand at Halloween, Christmas, Chinese New Year, summer holidays as well as other special occasions. Since opening, HKD had employed more than 320 disabled staff members.

Concerns expressed by Members in previous discussions

11. Since the opening of HKD in September 2005, Members have raised a number of questions at Council meetings on issues related to the operation and performance of the park, public transport services for visitors, employment matters, financial and governance arrangements as well as injection of funds into HKD. The Panel on Economic Development ("the Panel") has deliberated on related issues when the Administration reported on the operation of HKD each year. In 2009, the Panel held a series of meetings to examine the HKD expansion project before the proposal was submitted to FC for approval. The views and concerns expressed by Members at the relevant meetings are summarized in the ensuing paragraphs.

Park attendance and marketing strategy

12. While noting the increase in HKD's attendance in 2010-11, which surged to 5.9 million, Members urged at the Panel meeting on 17 January 2012 that HKD should make better efforts to ensure continued increase in its attendance to bring about sufficient earnings one day to offset its net loss, which in 2010-2011 was \$237 million. The Administration advised that HKD was a long-term investment and with improved promotion and operation, attendance and guest spending in HKD would further increase, leading to improvement to HKD's financial conditions.

13. Some Members expressed concern about the increase in operating costs of HKD, especially after its expansion. Members noted that the major cause of cost increase was staff cost which made up about one-third to 40% of HKD's costs and was directly related to the increase in attendance. Members further noted that HKD had been examining various cost control measures in the areas of personnel management, energy management and procurement and merchandising, with a view to minimizing operation costs.

14. At previous Panel meetings, some Panel members expressed concern that the patronage to the park had fallen short of the base case scenario projected in 1999, and they urged the park management to step up promotional and marketing efforts to boost attendance. In particular, members highlighted the need to draw up a comprehensive business plan to tie in with the expansion project. They noted that the number of complimentary tickets given out by HKD each year for use during low seasons accounted for about 1% to 2% of total tickets. HKD was requested to present the attendance figures in respect of complimentary tickets separately from regular admissions in future updates.

15. Some Panel members suggested that HKD should incorporate more local cultural elements to suit the taste of the local public in order to stabilize the local source market, and direct more marketing efforts and resources to expand the Mainland market, in particular in view that there was a drop in the share of international visitors in the total attendance. They suggested that HKD should consider partnering with the Ocean Park, Asia World Expo and other scenic spots in offering city pass for visitors, and collaborate with the travel trade in the Mainland and other source markets in Asia in promoting the park and the two hotels to tourists visiting Hong Kong.

16. To attract more visitors to HKD, some Members considered it important to enhance the accessibility of the theme park through the provision of different transport facilities, such as making better use of the pier near HKD. They urged the Government to put the land adjacent to HKD to more gainful use, with a view to enhancing synergies with HKD and boosting patronage to the park. In view of the competition from local and regional theme parks including Ocean Park, the prospective Disneyland in Shanghai and the Universal Studio in Singapore, members expressed concern about the business viability of HKD, and stressed the importance to improve the park's operation and management to withstand the fierce competition.

17. At the Panel meeting on 25 January 2010, HKD advised that it had focused marketing strategies on 24 Mainland cities and would set up the fourth Mainland sales office in Chengdu in March 2010. To capitalize on the latest arrangements under the Mainland and Hong Kong Closer Economic Partnership Arrangement for permanent Shenzhen residents and non-Guangdong residents in Shenzhen to visit Hong Kong, HKD was studying the feasibility of a multiple ticket scheme for visitors from Guangzhou and Shenzhen. To attract local visitors and encourage repeat visitations, HKD would continue to launch a variety of theme-based and innovative events in different seasonal periods. It had also been working with MTR Corporation Limited ("MTRCL"), airlines, hotels, shopping centres and scenic spots such as the Peak and Ngong Ping 360 in organizing joint promotions, while collaborations with other scenic spots were under discussion.

18. HKD further advised at the Panel meeting on 24 January 2011 that it had expanded the marketing activities from 24 to 28 Mainland cities and it would continue focusing efforts on the top nine markets in Asia and Australia. In order to enhance sales volume, HKD had created evolving product offers to capture different markets and segments, such as maintaining the strategic partnership with local airlines in joint promotions during slow periods and working with various national carriers and budget airlines in key source markets. Panel members considered that HKD should make greater efforts to boost park attendance, explore various marketing strategies and get

prepared to compete with the Shanghai Disneyland which was due to be completed by mid-2014. A member urged the Administration to review and take the lead in the overall planning of tourism infrastructures on the Lantau Island so as to connect the various attractions and enhance the appeal of the Island to tourists.

Park management and financial performance

19. A Member raised a question at the Council meeting on 2 November 2005 concerning whether there was conflict in the Government's roles as the rule-setting authority for the market on the one hand, and as a market participant for being the major shareholder of HKITP on the other. Some Members expressed concern about how the Government directors in the Board of HKITP could monitor the operation of the park effectively, in particular the expenditure on HKD's expansion. Some Members suggested appointing a greater number of independent directors from the business and financial fields as well as the travel trade to the Board to oversee HKITP's operation.

20. At the Panel meeting on 25 January 2010, members welcomed the initiative to enhance the transparency of HKD's financial performance. Some members requested HKD to provide more detailed information in the annual disclosure of its operating and financial results, such as breakdown of operating costs and expenses. They also stressed the importance to put in place a mechanism to ensure that HKD's expenditure would be processed in a transparent manner. Responding to members' concerns raised at the meeting on 25 January 2010 about the financial results in 2008-2009, HKD explained that in-park spending had suffered setbacks due to global economic downturn and the outbreak of swine influenza, whereas the net loss for the year was mainly due to depreciation of assets which would nevertheless continue to generate revenue for the park without affecting cash flow. The park management was confident that the financial performance of HKITP would improve in near future.

21. At the Panel meeting on 24 January 2011, members urged HKD to boost park attendance in order to turn the HKD operation into a profit. The Administration advised that HKD would have to press fully ahead with its expansion plan, and continue with its marketing and promotion activities to drive attendance. As HKD was an important brand of Hong Kong, its performance had a direct impact on the image and tourism development of Hong Kong.

22. As for the calculation of base management fee, Panel members considered it difficult to assess the new formula in the absence of information on the financial performance of HKITP in previous years. To safeguard the interests of HKD, it was suggested that the lowest rate generated by the two formulas should be adopted for calculating the base management fee, and a park attendance threshold should be set as a criterion for disbursing the management fee. A Panel member suggested that the Government should negotiate with WD for pegging the base management fee to a percentage of earnings after interest, tax, depreciation and amortization.

Investment return and economic benefits

23. In a question raised at the Council meeting on 4 June 2008, there was a suggestion that value for money audit on the tourism infrastructure projects, including HKD, should be conducted to assess their performance. Given the unsatisfactory park attendance in the past and the discrepancy in the economic assessment of the expanded HKD project and attendance projections made by WD and the Government, some Members had grave doubts about the viability of HKD, and whether the new agreement would serve the best interests of Hong Kong people. These Members also questioned the reliability of the projection of investment return of HKD as some financial data were not made available by WD.

24. At the Panel meeting on 30 June 2009, a member pointed out that both direct and indirect investment in the project, such as the reclamation works at the initial stage of development and the waiving of claims for dividends from MTRCL in the construction of the Disneyland Resort Line, should be taken into account in calculating the investment return of HKD. There were also concerns about the constraints imposed on the conversion of the \$4 billion subordinated shares that represented the land premium for the phase 1 HKD to ordinary shares following the park expansion¹⁰.

Staffing

25. When discussing the creation of job opportunities under the expansion project at the Panel meeting on 4 July 2009, some members

¹⁰ In 1999, the Government and WD 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". Both sides also agreed 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's 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 could 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.

stressed that priority should be given to employing local labour force, in particular those Imagineers who had been laid off by WD previously. In addressing members' concern raised at the meeting on 25 January 2010 about staff being laid off and work-related injuries, HKD advised that since the park's opening in 2005, it had not laid off any staff. The number of work injuries decreased from 469 cases in 2008 to 366 cases in 2009. HKD further advised at the meeting on 24 January 2011 that it had since 2007 cooperated with a number of non-government organizations and created an Apprenticeship Programme for persons with disabilities which provided individuals with disabilities nine months of paid job training with transport allowances in tailor-made roles. At present, 20 of them were permanent cast members of HKD.

Corporate social responsibility

26. At the Panel meeting on 17 January 2012, members requested that HKD should employ more persons with disabilities (PwDs), sponsor more free visits to the Park by children from low-income families, and provide greater fare concessions to the elderly.

27. HKD advised that apart from directly employing more than 320 PwDs, HKD had made efforts to provide other job opportunities for PwDs, such as using flower arrangements from flower shops employing PwDs, and using costume mending service of social enterprises and/or PwD organizations. The one-million Disney Children's Fund was sponsoring children development programmes organized by six to seven non-government organizations. Over the years, HKD had sponsored free visits for about 500 000 children from low-income families. HKD had worked hard to help protect the environment, e.g. the replacement of energy inefficient incandescent lamps in HKD hotels with light emitting diode lamps which had saved HKD's energy consumption by about 10%. A Member was concerned that 320 was the cumulative figure since HKD's opening and not the current number of PwD staff. HKD was requested to inject more fund into the Disney Children's Fund in view of HKD's scale of operation. In previous Panel meetings, members also urged HKD to consider abolishing the daily fireworks event in order to protect the environment.

Future expansion

28. At the Panel meeting on 17 January 2012, a member expressed concern about the arrangements for funding the future expansion of HKD. Members noted that HKD believed that the increased attendance should generate sufficient funding to finance the future expansion of the Park, obviating the need to seek additional funding from shareholders. In response to members' request at the meeting, HKD provided the following

information to facilitate members' consideration of HKD's expansion plans in future –

- (a) Regarding the income from related transactions such as the sale it charged for use of its copyrights and patents, HKD was only a non-exclusive licensee of Disney intellectual property (such as Disney characters, music, design drawings, etc.). HKD did not own such property and derived no income from it;
- (b) As agreed with the Administration in July 2009, HKD started to publicly disclose financial information from 2009-2010. As presented in a previous Annual Business Review, HKD's net losses were \$237 million for 2010-2011, \$718 million for 2009-2010, \$1,315 million for 2008-2009 and \$1,574 million for 2007-2008;
- (c) HKD did not disclose the breakdowns of its total revenue in the 2010-2011 Annual Business Review by revenue stream, but as expected, HKD's most significant contributor to revenue was from admissions to the theme park. Based on the agreement made in July 2009, key revenue drivers were disclosed in the Annual Business Review; and
- (d) HKD's depreciation policy followed Hong Kong's generally accepted accounting principles and the relevant parts of the Hong Kong Financial Reporting Standards. It was also consistent with that for other similar classes of assets and equipment being operated in a theme park and entertainment business. Depreciation of property, plant and equipment was calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives. Leasehold land was amortized on a straight-line basis over the remaining lease term commencing from the operation of the park.

Latest development

29. At the meeting on 25 February 2013, the Administration and HKD will brief the Panel on the operation of HKD in 2011-2012.

References

30. The relevant papers are available at the following links –

Paper on "Update on proposed expansion of HKD (LC Paper No. CB(1)2090/08-09(01))

<http://www.legco.gov.hk/yr08-09/english/panels/eDEV/papers/eDEV0630cb1-2090-1-e.pdf>

Paper on "Update of HKD" (LC Paper No. CB(1)808/11-12(05))

<http://www.legco.gov.hk/yr11-12/english/panels/eDEV/papers/eDEV0117cb1-808-5-e.pdf>

Background Brief on HKD dated 17 January 2012 (LC Paper No. CB(1)808/11-12(06))

<http://www.legco.gov.hk/yr11-12/english/panels/eDEV/papers/eDEV0117cb1-808-6-e.pdf>

Minutes of Panel meeting on 17 January 2012 (LC Paper No. CB(1)1602/11-12(06))

<http://www.legco.gov.hk/yr11-12/english/panels/eDEV/minutes/eDEV20120117.pdf>

Supplementary information provided for Panel meeting on 17 January 2012 (LC Paper No. CB(1)2294/11-12(01))

<http://www.legco.gov.hk/yr11-12/english/panels/eDEV/papers/eDEV0117cb1-2294-1-e.pdf>

Council Business Division 1
Legislative Council Secretariat
18 February 2013

Disclosure of information on Hong Kong Disneyland (HKD)'s operating and financial results

The Government and The Walt Disney Company have agreed to publish an annual business review of HKD, starting with the operation year of 2008-2009, 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

In the disclosure in respect of the operation year of 2008-2009, the 2007-2008 figures will also be shown for comparison and reference.

(Source: Extracts from the Administration's supplementary information in LC Paper No. CB(1)2206/08-09(02) for the Panel on Economic Development meeting on 10 July 2009)