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Panel on Economic Development
Meeting on 28 November 2016

Background brief on development of
the Hong Kong Disneyland

Purpose

This paper provides background information on the development of the Hong Kong Disneyland ("HKDL") and summarizes the major views and concerns of Members expressed in the past on the subject.

Background

Development of HKDL

2. In December 1999, the Government entered into an agreement with The Walt Disney Company ("TWDC") to build HKDL Phase 1 at Penny's Bay. A joint venture company, the Hongkong International Theme Parks Limited ("HKITP"), was set up for this purpose¹. The Hong Kong Disneyland Management Limited ("HKDML") wholly-owned by TWDC is responsible for the day-to-day operation of HKDL.

¹ Under the agreement, the Government owns 57% of the shares in HKITP while TWDC 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.

Moreover, under the agreement, HKITP is given an Option to buy the site immediately to the east of the Phase 1 site for a second phase of the development. The Option is valid for 20 years from signature, with an automatic right to extend for a further five years and a conditional right to extend for a second five year period.

3. The then estimated total project cost to HKITP of developing HKDL Phase 1 was \$14.1 billion, in addition to an estimated cost of \$4 billion for reclaiming the land for Phase 1 of the project². The following summarises the financing of the project –

Funding Sources	Amount (\$ billion)	% to Total
Equity , of which	5.7	40.4%
- Government	3.25	23%
- TWDC	2.45	17.4%
Debt , of which	8.4	59.6%
- Government	6.1*	43.3%
- Commercial	2.3*	16.3%
Total	14.1	100

* Including capitalised interest.

Source: Paragraph 14 of FCR(1999-2000)48.

4. The related financial arrangements were approved by the Finance Committee ("FC") on 26 November 1999. HKDL was opened in September 2005, and consisted of a theme park and two hotels. The theme park provided four themed areas, namely Fantasyland, Tomorrowland, Adventureland and Main Street, USA.

Addition of three new themed areas

5. The Government and TWDC reached an agreement in July 2009 for an expansion plan in Phase 1 site of HKDL. The expansion proposal comprises three new themed areas, namely Toy Story Land, Grizzly Gulch and Mystic Point, which were opened in 2011, 2012 and 2013 respectively.

6. TWDC estimated that the expansion plan would cost \$3.63 billion. Under the relevant financial arrangements, TWDC has contributed all the necessary new capital (then estimated to be \$3.5 billion³) as equity for the construction of the new attractions as well as sustaining the park's operation during the construction years, and converted the entire outstanding balance

² The land premium for HKDL Phase 1 was HK\$4 billion, which was the estimated pro rata cost of the reclamation and site formation. HKITP has settled the land premium by issuing HK\$4 billion of subordinated equity shares to the Government. The shares would attract no dividend, initially, but would be convertible to ordinary shares in HKITP at a progressive rate depending on operating performance.

³ The difference between the project cost of \$3.63 billion and the amount of new capital to be injected by TWDC of \$3.5 billion would be bridged by the cash flow generated from the park's operation during the construction years.

of the TWDC loan (then projected to be \$2.76 billion including the amount drawn from the revolver) to equity. In total, TWDC had injected about \$6.25 billion as equity. To cater for unforeseen cash flow requirements during the construction years, a revolving credit facility of \$300 million provided by TWDC had been retained.

7. Although the Government did not inject any new capital for the expansion, it had converted part of its loan to equity to match the new capital contribution and loan conversion by TWDC, subject to the Government retaining a loan balance of not less than \$1 billion. The amount of Government loan to be converted over the construction years was estimated to be about \$6.25 billion. Upon the capital injection by TWDC and conversion of the Government and TWDC loans, the Government continued to be the majority shareholder of HKITP with ownership of about 52%.⁴ The related financial arrangements were approved by FC at the meeting on 10 July 2009.

8. The capital structure of HKITP before and after implementation of the expansion is set out in the following table –

	Government (in \$billion)	TWDC (in \$billion)	Total (in \$billion)
Capital structure as of July 2009:			
Ordinary equity	3.25 (57%)	2.45 (43%)	5.7
Subordinated equity	4	-	4
Loan	6.89	2.76	9.65
Projected capital structure after completion of park expansion:			
Ordinary equity	9.50 (52%)	8.70 (48%)	18.2
Subordinated equity	4	-	4
Loan	1	-	1

Note: According to the Administration, there would be some adjustment to the capital structure depending on the interest rate applicable to the Government loan, progress of construction and the company's cash flow during the expansion period.

Source: Enclosure 3 to FCR(2009-10)39.

Addition of a new themed area and a new hotel

9. On 8 October 2013, HKDML announced the launch of Disney's first Marvel themed area, the Stark Expo, which was based on the "Iron Man" character. This expansion project would be funded by HKITP's operating surplus. The attraction was expected to open in late 2016.

⁴ The Government's shares in HKITP was lowered from 57% to 52% under the expansion plan.

10. In February 2014, HKDML proposed to develop a 750-room new hotel located on the site between the existing Hong Kong Disneyland Hotel ("DLH") and Disney's Hollywood Hotel ("DHH"). The target opening date was early 2017.

11. HKDML estimated that the new hotel development would cost \$4.263 billion. The financial arrangements for HKDL to develop the new hotel were approved by FC at the meeting on 11 July 2014, the gist of which is set out below –

	Government (in \$billion)	TWDC (in \$billion)	HKITP (in \$billion)
Cash equity injection		1.7 (A)	
Conversion of existing Government loan to equity	1.7(Note)		
New shareholder loans	0.8085 (B)	1.1545 (C)	
Contribution by operating cash			0.6 (D)
Total Cash Contribution	0.8085	2.8545	0.6
Estimated Project Cost = (A) + (B) + (C) + (D) = \$4.263 billion			

Note: According to the Administration, the proposed conversion of the Government loan was intended to maintain the Government's majority shareholding in the joint venture. It was not part of the funding for the project cost.

Source: Paragraph 13 of FCR(2014-15)6.

12. The capital structure of HKITP before and after the above financial arrangements is set out below –

	Government (in \$billion)	TWDC (in \$billion)	Total (in \$billion)
Capital structure as at end of fiscal year 2013:			
Ordinary equity	8.6 (52%)	7.8 (48%)	16.4
Subordinated equity	4	-	4
Loan	2	-	2
	Government (in \$billion)	TWDC (in \$billion)	Total (in \$billion)
Projected capital structure after completion of the new hotel:			
Ordinary equity	10.3 (52%)	9.5 (48%)	19.8
Subordinated equity	4	-	4
Loan	1.1	1.1	2.2

Note: According to the Administration, there would be some adjustments to the capital structure depending on the interest rate applicable to the Government loan, progress of construction and the company's cash flow during the expansion period.

Source: Enclosure 6 to FCR(2014-15)6.

Operating and financial performance

13. The accumulated number of visitors received by HKDL and the combined occupancy rate of DLH and DHH are set out below –

Year*	Actual number of attendance (in million)	Combined occupancy rate of DLH and DHH
2005-2006	5.2	N/A
2006-2007	4	N/A
2007-2008	4.5	78%
2008-2009	4.6	70%
2009-2010	5.2	82%
2010-2011	5.9	91%
2011-2012	6.7	92%
2012-2013	7.4	94%
2013-2014	7.5	93%
2014-2015	6.8	79%

* Each year of operation of HKDL starts in October and ends in the next September.

14. As regards financial performance in 2014-2015, HKDL generated \$5,114 million of revenue which was about 6% lower than the previous year. The earnings before interest, taxes, depreciation and amortization were \$805 million, representing a year-on-year decrease of 36%. In 2014-2015, HKDL recorded a net loss of \$148 million, representing a decrease of \$480 million from \$332 million in the previous year. The revenues and net profit/(loss) of HKITP since 2008 are set out below –

Year*	Revenues (in \$million)	Net profit / (Loss) (in \$million)
2008-2009	2,541 (--)	(1,315)
2009-2010	3,013 (+18.6%)	(718)
2010-2011	3,630 (+20.5%)	(237)
2011-2012	4,272 (+17.7%)	109
2012-2013	4,896 (+14.6%)	242
2013-2014	5,466 (+11.6%)	332
2014-2015	5,114 (-6.4%)	(148)

* Each year of operation of HKDL starts in October and ends in the next September.

Views and concerns expressed by Members

Addition of three new themed areas

15. When consulted on the proposal to implement a package of arrangements relating to the expansion and operation of HKDL at the meetings of the Panel on Economic Development ("the Panel") held on 30 June, 4 July and 10 July 2009, members expressed diverse views on the proposal. Some members were in full support of the proposal which would help enhance the competitiveness of HKDL, boost patronage of the park and improve its financial performance. Some members however considered the agreement made between the Government and TWDC unfair to the Government and urged the Government to timely consult Members on related plans so as to allow adequate time for discussion prior to the signing of agreements. Some members also expressed concerns over the non-availability of data on HKDL's operations in particular the historical financial performance for members' consideration.

16. The Administration explained that the Government and TWDC were both bound by the confidentiality provision under the relevant agreement, and hence, such information could not be disclosed without consent by both parties. Notwithstanding this, in order to allow a better understanding of HKDL's operating and financial performance, the Government and TWDC agreed to publish an annual business review with information on the business and aggregate financial indicators of HKDL as from 2008-2009 onwards.

17. The above financial proposal was subsequently approved by FC at its meeting held on 10 July 2009. In the course of discussions, Members were particularly concerned about the projected patronage, investment returns and economic benefits of the proposal as well as the employment opportunities that could be generated by the proposal. Questions on the operation and management of the park as well as the related land use issues were also raised.

Addition of a new themed area and a new hotel

18. At the Panel meeting held on 28 October 2013, members were briefed on the progress of the expansion plan of HKDL's first Marvel themed area. Members expressed concern about the business viability of HKDL given the competition from local and regional theme parks, and particularly from the Shanghai Disneyland ("SDL") which was expected to be commissioned in 2015. They stressed the importance of improving the park's operation and management in attracting and retaining patrons.

19. When consulted on the proposal for a new hotel in HKDL at the Panel meeting held on 24 February 2014, the Panel indicated its general supported to the proposal. Some members took the opportunity to enquire the planning of the Phase 2 development of HKDL and urged HKITP to speed up the related work. In reply, the Administration advised that it had had initial discussion with TWDC on HKDL's Phase 2 development. While the current focus was on the full utilization of the Phase 1 site, it was likely that the development of the Phase 2 site might proceed ahead of schedule given the patronage of HKDL in the past couple of years and depending on market demands.

20. The financial proposal to provide a new term loan to HKITP for the construction of a new hotel was approved by FC on 11 July 2014. In the course of discussions, members were concerned about the investment return and expansion plan of HKDL, in particular the impact of SDL on HKDL. They examined in detail the proposed hotel development project, its economic benefits and pros and cons of the proposed financial arrangements as well as alternative options.

Phase 2 development

21. At the recent Panel meetings held on 16 February 2015 and 22 February 2016, some members reiterated the challenges posed by the opening of SDL and urged the Administration to expedite the Phase 2 development. The Administration advised that negotiations for Phase 2 development of HKDL had been going on, and there was no pre-determined date to complete the negotiation. The Administration would report to the Legislative Council when there was conclusion in the discussions.

22. Some members expressed concern about the cost-effectiveness of the Government's future investment in the Phase 2 development project. There was also an opinion that it would be unnecessary for the Government to provide highly favourable terms to support the project as in the case of Phase 1 development of HKDL. The Administration assured members that the Government was mindful of the scale of the Phase 2 development and would put public interest at the first place during the negotiation with TWDC. Considerations would be given on potential economic returns, Hong Kong's tourist receiving capacity, tourism development direction and infrastructure support when determining the way forward.

Council question

23. At the Council meeting on 17 December 2014, Hon CHAN Han-pan raised a question on HKDL's setting of prices for admission tickets and concessions. Hyperlink to the relevant written reply from the Administration is provided in the **Appendix**.

Latest development

24. At the meeting on 28 November 2016, the Administration will brief the Panel on the expansion and development of HKDL under Phase 1.

Relevant papers

25. A list of relevant papers which are available on the LegCo Website (<http://www.legco.gov.hk>) is in the **Appendix**.

Council Business Division 4
Legislative Council Secretariat
25 November 2016

Appendix

List of relevant papers

Issued by	Meeting Date/ Issue Date	Paper
Economic Services Bureau	18 November 1999	Legislative Council Brief on Hong Kong Disneyland (File Ref: ESB CR 18/2/511/98(99))
Panel on Economic Development	30 June 2009 (Item I)	Administration's paper Minutes
	4 July 2009 (Item I)	Minutes
	10 July 2009 (Item I)	Minutes
	28 October 2013 (Item IV)	Minutes
	24 February 2014 (Item V)	Minutes
	16 February 2015 (Item V)	Background brief Minutes
	22 February 2016 (Item V)	Administration's paper Background brief Minutes
Finance Committee	26 November 1999 (Item no. 2)	Administration's paper
	10 July 2009 (Item no. 3)	Administration's paper Minutes
	11 July 2014 (Item no. 1)	Administration's paper Minutes

Issued by	Meeting Date/ Issue Date	Paper
	6 April 2016	<u>Administration's replies to Members initial written questions</u> (Reply Serial Nos. 001, 151, 161, 218)
Council Meeting	17 December 2014	<u>Written reply by the Secretary for Commerce and Economic Development to a question on "Prices of admission tickets and concessions of Hong Kong Disneyland" raised by the Hon CHAN Han-pan</u>