Legislative Council
Panel on Economic Development

Update on Hong Kong Disneyland Resort

The Government's response to the motion passed at the meeting on 27 February 2017

PURPOSE

This note sets out the Government's response to the motion passed at the Panel meeting on 27 February 2017 regarding the arrangements of royalties and management fees payable by the Hong Kong Disneyland Resort ("HKDL") (at **Annex**).

RESPONSE TO THE MOTION PASSED

2. In the light of the said motion (see **Annex**) and Panel members' comments on the same issues as expressed at the Panel meetings on 28 November 2016 and 27 February 2017 regarding the expansion and development plan of HKDL ("the Plan"), the Government has conveyed Panel members' views to The Walt Disney Company ("TWDC") and has further discussed the matter with TWDC.

3. For the payment of royalties, we note that all Disney resorts outside the United States are charged for the access to and use of Disney's intellectual properties for the resorts' development and operation. Based on publicly released information, the royalty rate charged by TWDC on all Disney resorts outside the United States is largely the same at 5% to 10% of revenues, depending on the source of revenues (e.g. merchandise, food and beverage, admission, etc.). Having regard to the industry practice, TWDC advises that its royalty rate is in-line with the comparables in the media and entertainment sector[1].

4. As regards management fees, we note that HKDL's management fees have been fully linked to the resort's performance (i.e. earnings before interest, tax, depreciation and amortisation ("EBITDA")) since 2009, which is an

[1] For royalty rates in the media and entertainment industry, the median was 8% based on the market financial data up to 2000 (Russell Parr. *Royalty Rates for Licensing Intellectual Property*. Hoboken: John Wiley & Sons, Inc., 2007.).

improvement over the arrangement based on revenues as agreed in 1999 and can better incentivise the management company (i.e. the Hong Kong Disneyland Management Limited) to drive the business performance and operational efficiency of HKDL. According to the arrangements between the Government and TWDC in 2009, the formula for calculating the base management fee is adjusted to 6.5% of EBITDA, instead of the original formula of 2% of gross revenues, and the formula for calculating the variable management fee is adjusted from 2% to 8% of EBITDA to 0% to 8% of EBITDA.

5. Members may wish to note that for Disneyland Paris, the base management fees are charged at 1% to 6% of revenues, while the variable management fees are calculated based on 30% of pre-tax adjusted cash flow, in excess of 10% of gross fixed assets. As for Shanghai Disney Resort, its management fee mechanism was designed with reference to HKDL's arrangements before the improvement agreed in 2009 as mentioned in paragraph 4 above.

6. Under normal operations of Disney resorts, compared with the situations of Paris and Shanghai resorts as well as Hong Kong's arrangements before the improvement in 2009 where the management fees are tied to revenues, linking management fees to EBITDA is a more desirable mechanism. The current arrangements for HKDL have provided incentives for the management company to enhance the Hongkong International Theme Parks Limited ("HKITP")'s financial performance, while at the same time not being inferior to the management fee arrangements for other Disney resorts outside the United States.

7. The Government has, having regard to Panel members' views, put forward different ideas in adjusting HKDL's existing management fee arrangements to TWDC, such as linking the fees to net income, calculating the fees after deducting depreciation and amortisation from EBITDA, but TWDC has reservations given that TWDC's business in other Disney resorts outside the United States may be impacted, and that improvements to HKDL's management fee structure were already made in 2009. Nonetheless, in order to show its commitment to Hong Kong and the HKDL project, TWDC has agreed to, as part of the package of refinements to the overall arrangements for taking forward the Plan for submission to the Finance Committee's consideration and approval, waive the variable management fees payable by HKITP for Fiscal Year 2018 ("FY18") and FY19. This would be conducive to HKITP's financial performance during the initial stage of the implementation of the Plan, in particular at the time before the incremental attendance and hence the revenue as driven by the completion of new offerings and attractions under the Plan fully materialise.

WAY FORWARD

8. Members are invited to note the Government's response as set out above to the motion passed regarding HKDL's arrangements of royalties and management fees.

Tourism Commission
Commerce and Economic Development Bureau
March 2017

<u>Annex</u>

Motions passed at Panel on Economic Development meeting on 27 February 2017 regarding "Update on Hong Kong Disneyland Resort"

Original motion moved by : Hon Michael TIEN Puk-sun, BBS, JP
Amendment moved by : Hon Holden CHOW Ho-ding

This Panel urges the Government to discuss with The Walt Disney Company ("TWDC") for a review of the arrangement of royalties and management fees received annually by TWDC, including the waiving of partial royalties and management fees by TWDC as appropriate, and consider changing the calculation basis for the royalties and management fees received by TWDC from the current formula which is linked to earnings before interest, tax, depreciation and amortization ("EBITDA") to a formula linked to earnings after interest, tax, depreciation and amortization, with a view to ameliorating the unfair agreement terms and bargaining for better long-term interest for the Hong Kong Special Administrative Region Government as a shareholder of the Hong Kong Disneyland Resort, so as to safeguard the investment and use of public funds.