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Panel on Economic Development
Meeting on 25 February 2019

Updated background brief on 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 expressed by members of the Panel on Economic Development ("the Panel") on the subject in the past.

Background

2. HKDL is owned by the Hongkong International Theme Parks Limited ("HKITP")[1], a joint venture between the Government and The Walt Disney Company ("TWDC"), and is managed by the Hong Kong Disneyland Management Limited ("HKDML"), which is wholly owned by TWDC. At the end of fiscal year 2017, the Government owned a 53% majority interest in HKITP, with TWDC owning the remaining 47%.

3. HKDL has three themed hotels: the 750-room Disney Explorers Lodge,[2] the 600-room Disney's Hollywood Hotel and the 400-room Hong Kong Disneyland Hotel.

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[1] HKITP operates under the supervision of a Board of Directors, which comprises five Government directors, four Disney directors and two independent non-executive directors.

[2] Disney Explorers Lodge commenced operation on 30 April 2017.

Operating and financial performance

4. The accumulated number of visitors received by HKDL and the combined occupancy rate of the hotels in HKDL are set out below –

Year*	**Actual number of attendance (in million)**	**Combined hotel occupancy rate**
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%
2015-2016	6.1	79%
2016-2017	6.2	69%

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

5. As regards financial performance in 2016-2017, HKDL generated $5,118 million of revenues which was 8% higher than the previous year. Earnings before interest, taxes, depreciation and amortization ("EBITDA") were $914 million, representing a year-on-year increase of 28%. In 2016-2017, HKDL recorded a net loss of $345 million. 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)
2015-2016	4,750 (-7%)	(171)
2016-2017	5,118 (+8%)	(345)

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

Economic benefits and staffing establishment

6. According to the survey statistics from the Hong Kong Tourism Board and the operational data of HKDL, the additional spending of all HKDL visitors in Hong Kong was $15.7 billion in 2016-2017. HKDL brought about $8.3 billion of value-added to Hong Kong in 2016-2017, equivalent to around 0.33% of Hong Kong's Gross Domestic Product.

7. In 2016-2017, HKDL employed more than 5 000 full-time and 2 000 part-time staff members to cope with the additional demand arising from various festive seasons and other special events.

Recent expansion and development of HKDL

8. The Government announced on 22 November 2016 that it had reached an in-principle agreement with TWDC in respect of an expansion and development plan at the Phase 1 site of HKDL ("the Plan"). The Plan aimed to sustain and refresh HKDL's appeal through the launch of at least one new attraction almost every year from 2018 to 2023. The types of new attractions included new immersive themed areas, new/updated facilities and expansion of existing facilities. The Plan was estimated to cost $10.9 billion, originally proposed to be shared between the two shareholders according to the shareholding ratio, i.e. $5.8 billion and $5.1 billion to be injected by the Government and TWDC respectively.

9. The Panel was consulted on the Plan at the meeting on 28 November 2016. Members in general acknowledged the need to further enhance HKDL's appeal and competitiveness. The Panel, however, expressed grave concerns over a range of issues concerning the financial arrangements of the Plan. Members also urged the Administration to take the opportunity to rectify the unfair terms it had entered with TWDC, in particular those concerning the payment of royalties and management fees. The Panel passed three motions urging the Administration to set up a fund for the development of tourism with local features while promoting the Plan, defer the Plan until the Government had negotiated with TWDC to improve the current unfair terms and conditions in the agreement, request HKDML to publish more information and data before submitting a funding application for the Plan, and request TWDC to relax height restrictions of developments in the vicinity of HKDL.

10. In the light of the concerns raised by the Panel, the Government and TWDC subsequently agreed that the project cost would be funded on a 50:50 basis, i.e. $5.45 billion each. TWDC, having regard to the views of the Panel, agreed to waive HKDL's variable management fees payable by HKITP for 2017-2018 and 2018-2019, as part of the arrangement details

for taking forward the Plan. TWDC also agreed to explore relaxing the development restrictions in the vicinity of HKDL. The funding proposal was approved by the Finance Committee on 2 May 2017. In October 2017, HKDL officially commenced construction on the Plan.

Deliberations at the Panel meeting on 26 February 2018

11. The Panel was briefed on HKDL's annual business review for 2016-2017 at the meeting on 26 February 2018. Members noted that there was a 3% year-on-year rise in total park attendance to over 6.2 million in 2016-2017. Revenues increased by 8% from the previous year to $5,118 million. However, a net loss of $345 million was recorded for the year despite an EBITDA of $914 million.

12. HKDL advised that the net loss in 2016-2017 was attributable to, among other things, the increased depreciation arising from the new assets launched in the year and the retirement of certain assets for taking forward the Plan. In response to members' enquiry, HKDL advised that its policy for depreciation of assets was formulated according to Hong Kong Financial Reporting Standards and Hong Kong's generally accepted accounting principles, and was consistent with that for similar categories of assets and equipment of other theme parks (e.g. Ocean Park) and entertainment businesses. HKDL's depreciation of property, plant and equipment was calculated using the straight-line method which allocated the cost over the estimated useful life after deducting the residue value; and the depreciation period of different asset types of HKDL was shown in the following table –

Type of asset	**Depreciation period**
Buildings and improvements	3 – 40 years
Furniture, fixture and equipment	3 – 10 years
Machinery and equipment	3 – 40 years
Rides and amusements	8 – 25 years
Shows and parades	5 years

13. Taking into account the net loss in 2016-2017, some members queried if the projected annual total park attendance of 9 million by 2025 under the Plan could be achieved. HKDL expected that with the progressive launch of various new attractions under the Plan in the years to come, its attendance would have a steady year-on-year growth. The hotel occupancy would also increase accordingly, thereby increasing the overall revenues. HKDL further advised that with the opening of the new hotel

Disney Explorers Lodge in end-April 2017, the total number of hotel rooms available in HKDL increased from 1 000 to 1 750, representing a 75% increase in the hotel room inventory. In 2016-2017, there was a 16% year-on-year increase in the hotel room nights sold. To further drive the hotel occupancy, HKDL had launched various promotions and organized different activities/events to attract visitors to stay at HKDL's hotels.

14. The Panel had all along been concerned about the utilization of the vacant site reserved for the Phase 2 development of HKDL ("the Phase 2 Site") and the payment of management fees and royalties by HKDL to TWDC. The Panel passed two motions at the meeting urging the Administration to discuss with TWDC on utilizing the Phase 2 Site for short-term leasing and devising an offsetting mechanism to ensure that TWDC would only receive management fees and royalties from HKDL when HKDL achieved breakeven in its financial accounts.

15. On the utilization of the Phase 2 Site, the Administration advised that according to the Option Deed signed in 2000 between the Government and HKITP, the latter had an option to buy the site for taking forward the Phase 2 development plan. Such option was valid for 20 years until 2020 and might be extended twice, each for five years. Before HKITP exercised such option, the Phase 2 Site could be used for various short-term uses in accordance with the permitted land uses under the Deed of Restrictive Covenant, such as recreational facilities and sports facilities, etc.. When considering these short-term uses, the Administration would take into account whether such uses were compatible with the use and atmosphere of HKDL. In fact, the Phase 2 Site was used for hosting some short-term activities in the past, such as sports activities and group events.

16. On the payment of royalties and management fees, the Administration advised that generally speaking, Disney resorts outside the United States made payment of royalties and management fees to TWDC. According to the agreements between the Government and TWDC, the royalties payable by HKDL to TWDC were at 5% to 10% of revenues, depending on the source of revenues (e.g. merchandise, food and beverage, admission, etc.), for enabling HKDL to access and use Disney's intellectual properties for the resort's development and operation. This arrangement was largely the same as the royalties charged by TWDC for other Disney resorts outside the United States. TWDC also advised that its royalty rate was in-line with that of similar fees in the media and the entertainment sector.

17. Against the background that TWDC had agreed to waive the variable management fees payable by HKDL for 2017-2018 and 2018-2019

as part of the package of refinements to the overall arrangements for taking forward the Plan, some members urged the Administration to negotiate with TWDC on waiving the variable management fees beyond 2018-2019 if losses were again recorded after the year. The Administration advised that according to the agreements between the Government and TWDC, the management fee mechanism of HKDL had, since 2009, improved from using revenues as the basis to being fully linked to the resort's performance (i.e. EBITDA), which could better incentivize the management company of HKDL to drive business performance and operational efficiency. Under the arrangements implemented since 2009, the formula for calculating the base management fee was 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 was adjusted to 0% to 8% of EBITDA, instead of the original formula of 2% to 8% of EBITDA. Indeed, since the implementation of the improved management fee arrangements in 2009, HKITP had recorded positive EBITDA for eight consecutive years during fiscal years 2010 to 2017.

Latest development

18. The Administration will update the Panel on the operations of HKDL for 2017-2018 at the meeting on 25 February 2019.

Council questions

19. At the Council meetings of 14 December 2016, 28 March, 13 June and 4 July 2018, Hon WU Chi-wai, Hon Tony TSE and Hon Andrew WAN raised questions relating to the financial arrangements for the Plan, depreciation and amortization of HKDL, and the use of the Phase 2 Site. Hyperlinks to the Council questions and the Administration's responses are provided in the **Appendix**.

Relevant papers

20. A list of relevant papers which are available on the Legislative Council Website (http://www.legco.gov.hk) is in the **Appendix**.

Council Business Division 4
Legislative Council Secretariat
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Appendix

List of relevant papers

Issued by	Meeting Date/ Issue Date	Paper
Panel on Economic Development	26 February 2018 (Item IV)	Administration's paper Administration's follow-up paper Administration's response to the motions passed Background brief Minutes
Council Meeting	14 December 2016	Council question on "The expansion and development plan for the Hong Kong Disneyland Resort" raised by Hon WU Chi-wai
	28 March 2018	Council question on "Depreciation and amortization costs for the Hong Kong Disneyland Resort" raised by Hon WU Chi-wai
	13 June 2018	Council question on "Site reserved for the second phase development of the Hong Kong Disneyland" raised by Hon Tony TSE
	4 July 2018	Council question on "Use of a site reserved for Phase 2 development for the Hong Kong Disneyland" raised by Hon Andrew WAN
Finance Committee	2 May 2017	Administration's paper