

Hospitality

PROPERTY FUND

Hospitality Property Fund Limited

(Incorporated in the Republic of South Africa)
(Registration number 2005/014211/06)
JSE code for A-linked units: HPA ISIN: ZAE000076790
JSE code for B-linked units: HPB ISIN: ZAE000076808
("Hospitality" or "the Fund" or "the company")

Reviewed Results

for the year ended 30 June 2009 and interest payment declaration

- Distribution per A-linked unit 110,76c \uparrow 5%
- Distribution per B-linked unit 152,65c \downarrow 8,1%
- Property portfolio R3,4 billion \uparrow R1,1 billion

Comments

1. Introduction

Hospitality Property Fund Limited is a property loan stock company that invests exclusively in hotel and leisure properties. The Fund's units in issue comprise A- and B-linked units with A-linked units having a preferential claim to earnings with capped growth, whilst the B-linked units receive the balance of earnings.

The effect of the global financial crisis that is being felt across all sectors of the South African economy has become particularly evident in the hospitality sector since the latter part of last year. According to the Smith Travel Research Global Hotel Benchmark report, average occupancies in South Africa for the first six months of 2009 declined by 13,5% compared to the same period in 2008.

A similar decline in occupancies experienced by the Fund has resulted in lower distributable earnings being achieved. While the A-linked units' distribution for the year remained unaffected, the decrease in the Fund's distributable earnings has had a leveraged effect on the B-linked units' distribution.

2. Results

Total distributable earnings for the year decreased by 3% compared to 2008. The A-linked units' annual distribution of 110,76 cents grew by 5% over the previous year, in line with the Fund's distribution structure, while distributions in respect of the B-linked unit declined by 8,1% to 152,65 cents over a 12-month period.

As a result of deteriorating trading conditions in the second half of the year the total distributable earnings declined by 15,7% compared to the same period in 2008. This resulted in the B-linked units distribution for this period decreasing by 28,7% from 85,01 cents in 2008 to 60,61 cents. This decline was primarily due to lower than anticipated rentals received from properties under leases which are exposed to operational income. Trading conditions in the hotel and leisure sector have been adversely affected by the deterioration in the global and local economies with occupancies dropping dramatically in the last six months of the financial year. In addition, average room rates have shown limited growth, following a decline in business across all market segments (corporate, government, conferencing, foreign and domestic leisure). This has been further exacerbated by the entry of a number of new hotel developments in certain of the areas where the Fund's properties trade.

During the period under review, the Fund undertook a number of major refurbishments. While these initiatives will see the refurbished properties well positioned in the future, the re-launch of these products in the present environment has been particularly challenging.

A number of initiatives have been implemented to restructure business units to address declining operating profits.

The following table reflects the financial results for the year ended 30 June 2009 compared to the previous year.

Year ended 30 June	2009 (R'000)	2008 (R'000)	Variance (%)
Contractual Rental	256 686	196 230	30,8
Fund Expenses	(31 276)	(26 851)	16,5
Net Finance Costs	(63 172)	(10 345)	510,7
Profit before debenture interest	162 238	159 034	2,0
Recoupment of debenture interest	–	8 278	(100,0)
Debt interest	(162 238)	(167 312)	(3,0)
Distribution – A-linked unit	(68 219)	(64 972)	5,0
Distribution – B-linked unit	(94 019)	(102 340)	(8,1)
Distribution – A-linked unit (cents)	110,76	105,49	5,0
– Interim	54,72	52,11	5,0
– Final	56,04	53,38	5,0
Distribution – B-linked unit (cents)	152,65	166,16	(8,1)
– Interim	92,04	81,15	13,4
– Final	60,61	85,01	(28,7)

Approximately 75% of the Fund's revenue was derived from fixed rental agreements with CPI-linked escalations. The remaining 25% comprised variable rental which is linked to underlying hotel operational performance.

3. Property Portfolio

The Fund's portfolio comprises interests in 23 hotel and resort properties in South Africa. As at 30 June 2009 the portfolio was valued at R3,4 billion, translating to a net asset value per linked unit of R17,93 (excluding deferred taxation). The portfolio is segmented into three lease types, namely: fixed lease properties, C-Corp lease properties and variable lease properties.

Rentals under fixed lease agreements are determined by normal contractual lease terms, with inflation linked annual escalations. C-Corp lease agreements comprise approximately 50% initial fixed lease rental, with the remaining being a variable rental equivalent to 90% of the hotel's EBITDA (earnings before interest, tax, depreciation and amortisation) after deducting the fixed lease portion. Variable lease agreements consist of rentals based on EBITDA from the property's underlying operations.

All properties across the portfolio were fully let during the year. The average lease expiry is 7,63 years.

Star Grading (by Gross Rental Income)	R 000's		Locality (by Gross Rental Income)	R 000's	
2-star	1,347	1%	Gauteng	155,857	61%
3-star	100,264	38%	KwaZulu-Natal	39,062	15%
4-star	127,344	50%	Western Cape	38,014	15%
5-star	27,731	11%	Eastern Cape	18,468	7%
			Mpumalanga	5,285	2%

Lease type (by Gross Rental Income)	Fixed	Variable	Total	
Fixed	123,872	5,656	129,528	50%
C-Corp	67,567	45,117	112,684	44%
Variable		14,474	14,474	6%
	191,439	65,247	256,686	
	75%	25%	100%	

4. Acquisitions

The Holiday Inn Sandton – Rivonia Road was acquired on 26 September 2008. The total cost of the acquisition was R410 million. During the reporting period the Fund also acquired an additional interest in Champagne Sports Resort for a total sum of R11,5 million.

5. Development and Capital Projects

On completion of The Rosebank Hotel redevelopment, the hotel was branded as the first Crowne Plaza in South Africa and is now part of Intercontinental Hotels Group (IHG) which is the largest hotel branding company worldwide. The Crowne Plaza Johannesburg – The Rosebank was completed at a cost of R312 million. The expansion and refurbishment of the Mount Grace Country House & Spa at a cost of R145 million was completed in June 2009. The new conference centre and hotel refurbishment at Protea Hotel The Winkler was completed in April 2009 at a cost of R28 million. The refurbishments of the three properties in Richards Bay were also completed towards the end of the financial year at a combined cost of R47 million.

Management have taken the decision to delay proposed refurbishments to the Protea Hotel Victoria Junction in Cape Town, Protea Hotel Marine in Port Elizabeth and Protea Hotel Imperial until after the World Cup in 2010 to avoid any disruption to operations during this period.

6. Borrowings

The Fund's interest-bearing liabilities increased by R733,8 million to R1 013,6 million at year-end.* The Fund's weighted average cost of debt for the year was 10,2% and the gearing ratio was 29,8% of total property value.

During the calendar year 2008 the Fund restructured its borrowings by entering into various interest-rate swap agreements as detailed below. In compliance with International Financial Reporting Standards (IFRS) these swap agreements have been valued on a mark-to-market basis. The derivative liability of R70,4 million compared to an asset value of R40,8 million at June 2008 gives rise to a fair value adjustment of R111,2 million being charged to the income statement. This fair value adjustment has no effect on the distribution to linked unitholders but adversely affects both the earnings and headline earnings.

*In terms of Section 8.58(a) of the JSE Limited's Listings Requirements, Hospitality is required to disclose the effect of any exceptional increase in borrowings on earnings per linked unit (EPLU) and headline earnings per linked unit (HEPLU) during the period under review. As the borrowings were used mainly to fund the acquisition of the Holiday Inn Sandton and to complete the development projects detailed above, it would not be possible to measure the effect of the increase in borrowings on EPLU and HEPLU.

	All-in Fixed Rate	Commencement Date	Maturity Date
R253 million*	10,45%	April 2008	May 2012
R150 million	11,45%	August 2008	August 2013
R150 million**	11,15%	December 2008	December 2011
R249 million***	12,01%	September 2008	September 2015
R170 million	11,33%	September 2008	September 2018
R972 million			

* Extendable at the option of the funder to May 2014.

** Extendable at the option of the funder to December 2013.

*** Step up swap structure – weighted average rate.

7. Unitholders

During the year some 17,8% of the A-linked units and 49,9% of the B-linked units were traded. The Fund has a BEE ownership component of 22,6%.

8. Subsequent events

Over the past few years there has been a significant shift from externally to internally managed property companies, both internationally and in South Africa. In line with this, the Board appointed an independent subcommittee and corporate advisors to investigate the internalisation of Hospitality's management company. The outcome of this investigation and subsequent negotiations has resulted in the Board, on 19 August 2009, approving the acquisition of the management company and the internalisation of the Fund's management. Further details of this proposed transaction are published simultaneously with this announcement.

9. Prospects

Despite the recent interest rate declines, the outlook for the property and hospitality sectors remains challenging. A continuing recessionary environment, budgetary constraints in the corporate and government sectors as well as limited personal disposable income is likely to result in continuing pressure on both occupancies and average room rates for the remainder of 2009. The outlook for calendar year 2010 is more positive with the prospect of economic recovery and enhanced returns as a result of the lead up to and the event of the FIFA World Cup 2010. It is important to note, however, that only half of the event will take place within the 2010 financial year. The refurbished portfolio is well positioned to benefit from improved market activity in the future.

10. Payments of Debenture Interest

Unitholders will receive debenture interest payment number 7 for the six-month period ended June 2009, of 56,04 cents per A-linked unit and 60,61 cents per B-linked unit.

	2009
Last day to trade <i>cum</i> interest	Friday, 4 September
Linked units will trade ex-interest	Monday, 7 September
Record date	Friday, 11 September
Payment date	Monday, 14 September
Unitholders may not dematerialise or rematerialise their linked units between Monday, 7 September 2009 and Friday, 11 September 2009, both days inclusive.	

Basis of preparation and accounting policies

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), including IAS 34 and the requirements of the Companies Act of South Africa (Act 61 of 1973) as amended. KPMG Inc, the independent auditor, has reviewed the financial statements contained in this preliminary report and has expressed an unmodified opinion on the preliminary financial statements. Their review report is available for inspection at the Fund's registered offices.

The accounting policies are consistent with those applied in the most recent audited financial statements.

The financial statements are prepared on the historic cost basis, except for investment properties and derivatives which are measured at fair value. The significant accounting policies are as follows:

- Investment property is initially recognised at cost including transaction costs. Subsequent to initial measurement, investment property is measured at fair value. Gains or losses arising from changes in fair value are included in net profit or loss for the period in which they arise. These gains or losses are transferred to a fair value reserve as they are not available for distribution.
- Interest-bearing liabilities and debenture capital are measured at amortised cost.
- Revenue comprises rental income from the letting of investment property and is accounted for on a straight-line basis over the period of the lease in terms of IAS 17.
- Deferred taxation on the fair value adjustment of investment properties has been calculated at 14% on land value and 28% on buildings.

By order of the Board

T E Sewell
(Chairman)

G A Nelson
(Chief Executive Officer)

19 August 2009

Directors: T E Sewell (Chairman)*, G A Nelson (CEO), Y Aminzadeh (Dutch), R Asmal, K H Abdul-Karrim**, Z N Kubukeli**, B M Madumise**, V J Midgley*, A S Rogers (Deputy CEO), W C Ross**+

(*Non-executive, +Independent)

Registered Office: "3 on Glenhove", Cnr Tottenham Avenue & Glenhove Road, Melrose Estate, 2196
Tel: +27 11 994 6320 Fax: +27 11 994 6321 E-mail: info@hpf.co.za Website: www.hpf.co.za

Financial results

Income statement

for the year ended 30 June	Reviewed 2009 R'000	Audited 2008 R'000
Revenue	261 919	200 594
Rental income – contractual	256 686	196 230
– straight-line accrual	5 233	4 364
Expenditure	(31 276)	(26 851)
Property and other operating expenses	(31 276)	(26 851)
Operating profit	230 643	173 743
Net finance cost	(63 172)	(10 345)
Finance income	24 139	24 022
Finance costs	(87 311)	(34 367)
Profit before debenture interest, fair value adjustments and taxation	167 471	163 398
Recoupment of debenture interest	–	8 278
Debt interest	(162 238)	(167 312)
Profit before fair value adjustments and taxation	5 233	4 364
Fair value adjustments	88 116	295 096
Revaluation of investment properties	204 619	269 149
Straight-line rental income accrual	(5 233)	(4 364)
Interest-rate swaps	(111 270)	30 311
Profit before taxation	93 349	299 460
Taxation	(54 889)	(71 017)
Profit for the year	38 460	228 443
Reconciliation between earnings, headline earnings and distributable earnings:		
Profit for the year	38 460	228 443
<i>Adjustments:</i>		
Debt interest	162 238	167 312
Earnings (linked units)	200 698	395 755
<i>Adjustments:</i>		
Fair value – investment properties revaluation (net of taxation)	(149 730)	(198 132)
Fair value – straight-line rental income	5 233	4 364
Headline earnings (linked units)	56 201	201 987
Fair value – interest rate swaps	111 270	(30 311)
Straight-line rental income	(5 233)	(4 364)
Distributable earnings	162 238	167 312
Number of units		
A-linked unit	61 591 087	61 591 087
B-linked unit	61 591 087	61 591 087
Weighted average number of units		
A-linked unit	61 591 087	56 637 584
B-linked unit	61 591 087	56 637 584
Distribution per linked unit (cents)		
A-linked unit	110,76	105,49
– Interim	54,72	52,11
– Final	56,04	53,38
B-linked unit	152,65	166,16
– Interim	92,04	81,15
– Final	60,61	85,01
	263,41	271,65
Earnings per linked unit (cents)		
A-linked unit	162,93	349,38
B-linked unit	162,93	349,38
	325,86	698,76
Headline earnings per linked unit (cents)		
A-linked unit	45,62	178,32
B-linked unit	45,62	178,32
	91,24	356,64
Earnings and diluted earnings per ordinary share (cents)	31,22	201,67

Balance sheet

at 30 June	Reviewed 2009 R'000	Audited 2008 R'000
ASSETS		
Non-current assets	3 404 252	2 300 495
Investment properties	3 389 043	2 249 704
Straight-line rent income accrual	15 209	9 976
Derivative asset	–	40 815
Current assets	12 619	207 128
Trade and other receivables	2 791	17 522
Cash and cash equivalents	9 828	189 606
Total assets	3 416 871	2 507 623
EQUITY AND LIABILITIES		
Equity	809 265	770 990
Share capital and share premium	246 963	247 148
Retained earnings	980	980
Fair value reserve	561 322	522 862
Non-current liabilities	2 483 644	1 624 462
Debentures	1 157 912	1 157 912
Interest-bearing liabilities	1 013 564	279 726
Derivative liability	70 456	–
Deferred taxation	241 712	186 824
Current liabilities	123 962	112 171
Trade and other payables	52 115	26 935
Debt interest payable	71 847	85 236
Total equity and liabilities	3 416 871	2 507 623
Net asset value per linked unit (Rand)		
A-linked unit	15,97	15,66
B-linked unit	15,97	15,66
Net asset value per linked unit (excluding deferred taxation)		
A-linked unit	17,93	17,18
B-linked unit	17,93	17,18

Statements of changes in equity

for the year ended 30 June	Share capital R'000	Share premium R'000	Retained earnings R'000	Fair value reserve R'000	Total R'000
Balance at 30 June 2007	9	64 881	4 815	290 584	360 289
Issue of ordinary shares	3	192 737	–	–	192 740
Share issue expenses	–	(10 482)	–	–	(10 482)
Profit for the period/total income and expenses for the year	–	–	228 443	–	228 443
Transfer to/(from) fair value reserve – revaluation of investment properties (net of deferred tax)	–	–	(198 132)	198 132	–
Transfer to/(from) fair value reserve – straight line rental income	–	–	(3 835)	3 835	–
Transfer to/(from) fair value reserve – interest rate swaps	–	–	(30 311)	30 311	–
Balance at 30 June 2008	12	247 136	980	522 862	770 990
Share issue expenses	–	(185)	–	–	(185)
Profit for the year/total income and expenses for the year	–	–	38 460	–	38 460
Transfer (from)/to fair value reserve – revaluation of investment properties (net of deferred tax)	–	–	(149 730)	149 730	–
Transfer to/(from) fair value reserve – interest rate swaps	–	–	111 270	(111 270)	–
Balance at 30 June 2009	12	246 951	980	561 322	809 265

Cash flow statement

for the year ended 30 June	Reviewed 2009 R'000	Audited 2008 R'000
Cash flows from operating activities	265 321	133 969
Cash generated from operations	24 139	24 022
Finance income received	(87 311)	(34 367)
Finance costs paid	(175 627)	(129 770)
Distribution to unitholders	–	–
Net cash inflow/(outflow) from operating activities	26 522	(6 146)