

Hospitality

PROPERTY FUND

Hospitality Property Fund Limited
(Incorporated in the Republic of South Africa)
(Registration number 2005/014211/06)

Share code for A-linked units: HPA ISIN for A-linked units: ZAE000076790
Share code for B-linked units: HPB ISIN for B-linked units: ZAE000076808
("Hospitality" or "the fund" or "the company")

Unaudited Interim Results

for the six months ended 31 December 2010 and interest payment declaration

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 an equal number of 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.

While the South African hotel industry benefitted over the first ten days of the new financial year from the tail end of the FIFA World Cup 2010 event, national hotel occupancies (all hotels) for the month of July 2010, per STR Global, reflected a year-on-year decline of 7.5%. However, this was more than offset by an increase in the average daily room rates (ADR) of 64.7% for this month, resulting in a revenue per available room (RevPar) improvement of 52.5%.

Trading conditions over the remaining five months of the reporting period remained challenging, due to the continuing effects of restrained demand, coupled with an oversupply of available room stock as a consequence of new hotel developments completed pre-World Cup. This has resulted in aggressive competition for business with widespread discounting to secure selected base business volumes.

Trading data received from STR Global for the six month period under review in respect of Hospitality's competitor set properties reflects a decline in average occupancies of 1.1% and an increase in ADR of 5.3% resulting in RevPar growth of 3.9%. The Fund's comparable trading figures over this period reflected almost identical trends in year-on-year variances.

Coupled with the subdued trading conditions, hotel owners are having to absorb increases in overhead costs significantly above the level of inflation. In particular, escalations in administered prices such as electricity, water and municipal rates have had a marked effect on earnings.

Insofar as the Fund's fixed lease properties are concerned, management are cognisant of the current financial pressures on tenants and continuously monitors the underlying businesses in order to evaluate serviceability of rentals.

2. Results

Rental income grew by 6.6% mainly due to the acquisition of the Protea Edward in June 2010. Fund expenses declined by some R6.4 million, as a result of savings achieved through the internalisation of the Fund's management company (Manco) in December 2009. Net finance costs increased by R2.7 million due to higher debt incurred to fund various refurbishments and the Manco acquisition, partly offset by interest earned on the cash raised through a rights issue concluded during November 2010.

The A-linked units distribution of 60.33 cents grew by 5% over the previous period, in line with the Fund's distribution structure, while the distribution on the B-linked unit increased by 5.9% to 38.45 cents.

The B-linked unit distribution, however, reflected a decline of 13.23 cents compared to the final distribution for the six months to June 2010 of 51.68 cents, mainly due to the higher rentals achieved in June 2010 during the World Cup period.

The following table reflects the financial results for the six months ended 31 December 2010 compared to the previous corresponding reporting period.

Six months to 31 December

	2010 (R'000)	2009 (R'000)	Variance (R'000)	Variance (%)
Contractual rental	137 039	128 526	8 513	6.6
Fund expenses	(9 704)	(16 086)	6 382	39.7
Net finance costs	(57 191)	(54 455)	(2 736)	-5.0
Profit before debenture interest	70 144	57 985	12 159	21.0
Recoupment of debenture interest	17 534	1 186	16 348	1378.4
Debenture interest	(87 678)	(59 171)	(28 507)	-48.2
Distribution – A-linked unit	(53 548)	(36 261)	(17 287)	-47.7
Distribution – B-linked unit	(30 130)	(22 910)	(11 220)	-49.0
Distribution – A-linked unit (cents)	60.33	57.46	2.87	5.0
Distribution – B-linked unit (cents)	38.45	36.30	2.15	5.9
Combined distribution – unit (cents)	98.78	93.76	5.02	5.4

** Refer to note 4 of the commentary.

Approximately 84% of the Fund's revenue was derived from fixed rentals with CPI-linked escalations and the remaining 26% comprised variable rentals which are linked to underlying hotel operational performance.

3. Acquisition of Arabella Portfolio

As previously announced on SENS, at a special general meeting held on 12 November 2010, unitholders approved all the resolutions required to implement the proposed acquisition by Hospitality of the property letting and hotel businesses carried on under the name of The Westin Grand Cape Town Arabella Quays Hotel ("the Westin") and the Arabella Western Cape Hotel and Spa ("AWCHS") together with certain properties which includes 460 hectares of undeveloped land adjoining AWCHS (Phase 2 land). The total purchase consideration will be an amount of R741.2 million which includes approximately R26 million of working capital liabilities of the Arabella Hotels which will be assumed by HPF Properties (Pty) Limited ("HPF Properties"). The acquisition will be funded from the proceeds of the R490 million rights offer and new debt facilities.

The transaction was subject to fulfillment or waiver (where applicable) of various conditions precedent all of which have been fulfilled, including the signature of the services and licensing agreements with Starwood Hotels and Resorts Worldwide, Inc. and Starwood EAME License and Services Company BVBA for the Westin ("the Starwood Agreements"), other than:

- the obtaining of the approval of the Cape Town International Convention Centre Company (Proprietary) Limited ("Convenco") to the assignment of Arabella South Africa Holding (Pty) Limited's ("ASAH") interests as tenant in terms of the sub-lease between it and Convenco in respect of the Westin to HPF Properties;
- the conclusion of new leases in respect of the Westin and AWCHS; and
- the Starwood Agreements becoming unconditional.

The principal condition precedent, to which the others are linked, is obtaining the approval of Convenco referred to above. This matter has taken longer than initially expected and both HPF Properties and ASAH are giving this the highest priority.

After the Arabella transaction has become unconditional and has been implemented, it is intended that the Phase 2 land (subject to the granting of development rights applied for) as well as certain of the Phase 1 land will be treated as trading stock. While this is likely to contribute to the Fund's distributable earnings in the medium term, the delayed conclusion of the Arabella transaction implies that this expected benefit will likely manifest from the next financial year onwards.

4. Rights issue

The Fund successfully concluded a rights offer on the 15 November 2010. A total consideration of R490 million was raised through the issue of 21 030 043 A-linked units at R12.80 each and 21 030 043 B-linked units at R10.50. These funds have been allocated to part settlement of the purchase consideration for the Arabella portfolio.

An amount of R17.5 million of the rights offer proceeds has been allocated as a recoupment of debenture interest in respect of the period 1 July 2010 to 14 November 2010, as the rights issue units will receive a full distribution for the six months to 31 December 2010, despite being in issue for 1.5 months. This recoupment is necessary in order to ensure that pre rights issue unitholders distributions are not unjustifiably diluted.

5. Internalisation of management company

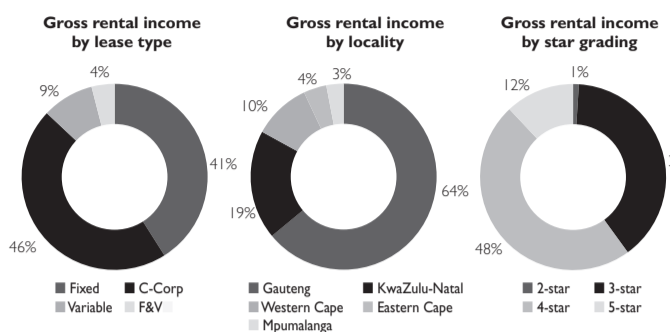
The internalisation of the management company implemented with effect from 01 December 2009 resulted in an effective saving for this reporting period in the region of R5.3 million. The initial purchase price of R123 million was settled in December 2009 and the remaining balance will be calculated at the end of June 2012, dependant on certain performance criteria and subject to a maximum value of R180 million escalated by CPI annually from the effective date.

6. Property Portfolio

The Fund's portfolio comprises interests in 24 hotel and resort properties in South Africa. As at 31 December 2010 the book value of the portfolio was R3.4 billion. The portfolio is segmented into four lease types, namely: fixed lease properties, C-Corp lease properties, fixed and variable leased properties (F&V) 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. F & V leases are similar to the C-Corp leases and consist of approximately 50% initial fixed rentals with the remainder being variable. Variable lease agreements consist of rentals based on EBITDA from the property's underlying operations.

The net asset value per linked unit as at 31 December 2010 was R13.95 (excluding deferred taxation). The average lease expiry period is 6.7 years.



7. Development and Capital Projects

The refurbishment of the Protea Marine (Port Elizabeth) was successfully completed during December 2010 at a total cost of R28 million. Initial indications are that the new offering has been well received by the market and should assist in this property increasing its market share. Construction of the new conference centre and 40 additional rooms at Champagne Sports Resort (Drakensberg) at a cost of R28 million was also completed in January 2011. As this property is under fixed lease, the capital cost has been rentalised.

The recently acquired Protea Edward (Durban) is presently undergoing an upgrade at a cost of R7 million and will be re-launched later this year to coincide with the hotel's centenary.

Refurbishment of the Protea Hotel Victoria Junction (Cape Town) at an anticipated cost of R42 million and the Inn on the Square (Greenmarket Square – Cape Town) at an expected cost of R34 million are due to take place during the winter of 2011 as Cape Town occupancies are lowest during this period. Protea Hazzyview is also due to be upgraded at a cost of R9.5 million.

On completion of the above all properties in the C-Corp and F & V lease portfolios will have been refurbished. This will ensure that the quality of the Fund's properties is of a high standard and will provide a solid platform to benefit from improved trading as the market recovers.

8. Borrowings

The Fund's interest bearing liabilities increased by R108 million to R1 416 million during the reporting period.

The Fund's weighted average cost of debt for the period was 8.9% and the gearing ratio at 30 June 2010 was 41.9% of total asset value. On conclusion of the Arabella portfolio acquisition the gearing level will reduce to 39.3%.

In compliance with International Financial Reporting Standards (IFRS) interest swap agreements are valued on a mark-to-market basis. A fair value adjustment of R27.3 million has been 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. The current swap profile is detailed below:

	All-in Fixed Rate	Commencement Date	Maturity Date
R347 million	8,72%	June 2010	June 2013
R347 million	9,05%	June 2010	June 2014
R347 million	9,28%	June 2010	June 2015
R1 041 million			

9. Unitholders

During the period some 10.3% of the A-linked units and 15.3% of the B-linked units were traded. The Fund has a BEE ownership component of 15.67% of the units in issue.

10. Prospects and Trading statement

The current trading environment is extremely challenging and albeit that there are some signs of improving economic conditions, management expects the hotel trading environment for the remainder of this financial year to remain difficult due to the increased room supply and limited growth in corporate, conference and leisure travel spend. The unexpected delay in the transfer of the Arabella portfolio implies that the anticipated earnings enhancement from this transaction is likely to be delayed to the next financial year. This is exacerbated by the rights issue proceeds currently earning a call interest rate, as opposed to the anticipated property yield expected from the Arabella portfolio.

Given that the prior year comparative included the World Cup period in June 2010 and based on information currently available, the directors expect distributions for the six months ending 30 June 2011 to be at least 13% lower than the distributions in the previous corresponding period. For the full financial year, this translates to a decline in distribution of at least 5%. Unitholders are reminded that the Fund's units in issue comprise A- and B- linked units, with A-linked units having a preferential claim to earnings with growth of 5% per linked unit for the next reporting period. The B-linked units receive the balance of the earnings and, due to this leveraging effect, distributions per B-linked unit are expected to be at least 34% down on the previous corresponding period. This translates into a decline in distribution of at least 18% for the full financial year. The information contained in the prospects section and the financial information on which this trading statement is based has not been reviewed and reported on by the fund's external auditors and does not constitute an earnings forecast.

The acquisition of the Arabella Portfolio is expected to enhance the Fund's earnings in the next financial year. The Westin in particular has a robust business model, which should provide a strong earnings underpinning, while the AWCHS will provide the Fund with an opportunity to realise profits from the sale of existing undeveloped stands.

11. Payments of Debenture Interest

Unitholders will receive debenture interest payment number 10 for the six-month period ended 31 December 2010 of 60,33 cents per A-linked unit and 38,45 cents per B-linked unit.

	2011
Last day to trade cum interest	Friday, 4 March
Linked units will trade ex-interest	Monday, 7 March
Record date	Friday, 11 March
Payment date	Monday, 14 March
Unitholders may not dematerialise or rematerialise their linked units between Monday, 7 March 2011 and Friday, 11 March 2011, both days inclusive.	

BASIS OF PREPARATION AND ACCOUNTING POLICIES

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), including the presentation and disclosure requirements of IAS34 and the requirements of the Companies Act of South Africa (Act 61 of 1973), as amended. KPMG Inc, the independent auditor, has not reviewed the 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, Leases.
- Deferred taxation on the fair value adjustment of investment properties has been calculated at 14% on land value and 28% on buildings.

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

By order of the Board

F M Berkeley
(Chairman)

GA Nelson
(Chief Executive Officer)

17 February 2011

Highlights:

- Distribution per A-linked unit 60.33c: 5% growth
- Distribution per B-linked unit 38.45c: 5.9% growth
- Rights offer concluded for R490 million
- Shareholder approval for Arabella portfolio acquisition

Hospitality
PROPERTY FUND

Statement of comprehensive income

for the six months ended 31 December 2010

	Unaudited Dec 2010 R'000	Unaudited Dec 2009 R'000	Audited June 2010 R'000
Revenue	137 259	130 150	265 550
Rental income – contractual	137 039	128 526	265 902
– straight-line accrual	220	1 624	(352)
Expenditure	(9 704)	(16 086)	(29 577)
Operating expenses	(9 704)	(16 086)	(29 577)
Operating profit/(loss)	127 555	114 064	235 973
Transaction costs on business combinations	–	(1 699)	(2 268)
Net finance cost	(57 191)	(54 455)	(108 593)
Finance income	4 339	1 000	2 023
Finance costs	(61 530)	(55 455)	(110 616)
Profit before debenture interest, goodwill, fair value adjustments and taxation	70 364	57 910	125 112
Recoupment of debenture interest	17 534	1 186	1 194
Debenture interest	(87 678)	(59 171)	(128 926)
Profit/(loss) before fair value adjustments, goodwill and taxation	220	(75)	(2 620)
Negative goodwill	–	–	587
Fair value adjustments	(27 532)	(2 387)	(309 855)
Investment properties, before straight-lining adjustment	–	–	(253 618)
Straight-line rental income accrual	(220)	(1,624)	352
Total fair value of investment properties	(220)	(1,624)	(253 266)
Contingent consideration	–	–	(2 287)
Interest-rate swaps	(27 312)	(763)	(54 302)
(Loss)/profit before taxation	(27 312)	(2 462)	(311 888)
Taxation	–	–	70 667
Total (loss)/profit and comprehensive (loss)/income for the period	(27 312)	(2 462)	(241 221)
Reconciliation between earnings, headline earnings and distributable earnings (loss)/profit for the period	(27 312)	(2 462)	(241 221)
Adjustments : Debenture interest	70 144	59 171	127 732
Earnings/(loss) (linked units)	42 832	56 709	(113 489)
Adjustments:			
Fair value – investment properties revaluation, net of tax	–	–	182,951
Fair value – straight line rental income	220	1 624	(352)
Headline earnings (linked units)	43 052	58 333	69 110
Fair value – interest rate swaps	27 312	763	54 302
Transaction costs on business combinations	–	1 699	2 268
Negative goodwill	–	–	(587)
Contingent consideration	–	–	2 287
Straight line rental income	(220)	(1 624)	352
Distributable earnings	70 144	59 171	127 732
Number of units/shares			
A-linked unit	88 761 391	63 112 101	63 112 101
B-linked unit	88 761 391	63 112 101	63 112 101
Weighted average number of units/shares			
A-linked unit	72 299 806	61 847 345	62 474 525
B-linked unit	72 299 806	61 847 345	62 474 525
Distribution per linked unit (cents)			
A-linked unit	60,33	57,46	116,30
– Interim	60,33	57,46	57,46
– Final	–	–	58,84
B-linked unit	38,45	36,30	87,98
– Interim	38,45	36,30	36,30
– Final	–	–	51,68
	98,78	93,76	204,28
Earnings/(loss) per linked units (cents)			
A-linked unit	29,62	45,85	(90,83)
B-linked unit	29,62	45,85	(90,83)
	59,24	91,69	(181,66)
Headline earnings per linked unit (cents)			
A-linked unit	29,77	47,16	55,31
B-linked unit	29,77	47,16	55,31
	59,55	94,32	110,62
(Loss)/earnings and diluted earnings per ordinary share (cents)	(18,89)	(1,99)	(193,06)

Statement of cash flows

for the six months ended 31 December 2010

	Unaudited Dec 2010 R'000	Unaudited Dec 2009 R'000	Audited June 2010 R'000
Cash flows from operating activities			
Cash generated from/(utilised in) operations	119 873	75 447	196 678
Finance income received	4 339	1 000	2 023
Finance costs paid	(61 530)	(55 455)	(110 616)
Distribution to unitholders	(69 752)	(71 847)	(129 827)
Net cash (outflow)/inflow from operating activities	(7 070)	(50 855)	(41 742)
Cash flows from investing activities			
Acquisition and development of investment properties	(174 012)	(8 451)	(56 249)
Acquisition of furniture and equipment	(553)	–	(750)
Acquisition of Manco	–	(124 699)	(122 268)
Restructure of interest rate swaps	–	–	(113 743)
Net cash outflow from investing activities	(174 565)	(133 150)	(293 010)
Cash flows from financing activities			
Proceeds from the issue of linked units	577 763	40 827	41 007
Share issue expenses paid	(11 776)	(175)	(180)
Interest-bearing liabilities raised	108 099	140 325	294 807
Net cash inflow from financing activities	674 086	180 977	335 634
Net increase/(decrease) in cash and cash equivalents	492 451	(3 028)	882
Cash and cash equivalents at beginning of year	10 710	9 828	9 828
Cash and cash equivalents at end of year	503 161	6 800	10 710

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

Statement of financial position

as at 31 December 2010

	Unaudited Dec 2010 R'000	Unaudited Dec 2009 R'000	Audited June 2010 R'000
ASSETS			
Non-current assets	3 535 327	3 603 546	3 471 279
Investment properties	3 366 405	3 411 079	3 303 013
Straight-line rent income accrual	15 077	1 624	14 857
Investment properties and related accrual	3 381 482	3 412 703	3 317 870
Furniture and equipment	1 023	732	587
Goodwill	152 822	190 111	152 822
Current assets	528 441	21 391	37 284
Trade and other receivables	25 280	14 591	26 574
Cash and cash equivalents	503 161	6 800	10 710
Total assets	4 063 768	3 624 937	3 508 563
EQUITY AND LIABILITIES			
Equity	636 744	819 035	580 276
Share capital and share premium	342 975	259 195	259 195
Retained earnings	(701)	(720)	(701)
Fair value reserve	294 470	560 560	321 782
Non-current liabilities	3 327 398	2 721 171	2 709 779
Debentures	1 668 714	1 186 507	1 186 507
Interest-bearing liabilities	1 416 470	1 153 889	1 308 371
Derivative liability	38 327	71 220	11 014
Contingent consideration	32 842	67 843	32 842
Deferred taxation	171 045	241 712	171 045
Current liabilities	99 626	84 731	218 508
Trade and other payables	11 948	26 746	38 356
Vendors on property acquisition	–	–	110 400
Debenture interest payable	87 678	57 985	69 752
Total equity and liabilities	4 063 768	3 624 937	3 508 563
A. Net asset value per linked unit (Rands)			
A-linked unit	12,99	16,21	14,00
B-linked unit	12,99	16,21	14,00
A. Net asset value per linked unit (excluding deferred taxation) (Rands)			
A-linked unit	13,95	18,17	15,35
B-linked unit	13,95	18,17	15,35

Statements of changes in equity

for the period ended 31 December 2010

	Share capital R'000	Share premium R'000	Retained earnings R'000	Fair value reserve R'000	Total R'000
Balance at 1 July 2009	12	246 951	980	561 322	809 265
Profit/Total comprehensive income for the year	–	–	(75)	(2 387)	(2 462)
Transactions with owners, recorded directly in equity	1	12 231	–	–	12 232
Issue of share capital	1	12 406	–	–	12 407
Share issue expenses	–	(175)	–	–	(175)
Balance at 31 December 2009	13	259 182	905	558 935	819 035
Balance at 1 July 2010	13	259 182	(701)	321 782	580 276
Loss/Total comprehensive loss for the year	–	–	(27 312)	–	(27 312)
Transactions with owners, recorded directly in equity	5	83 775	27 312	(27 312)	83 780
Issue of shares	5	95 551	–	–	95 556
Share issue expenses, net of tax	–	(11 776)	–	–	(11 776)
Transfer to fair value reserve – interest rate swaps	–	–	27 312	(27 312)	–
Balance at 31 December 2010	18	342 957	(701)	294 470	636 744

Condensed segmental information

for the six months ended 31 December 2010

Information regarding the results of each reportable segment is included below. Performance is measured based on operating profit before finance costs, as included in the internal management reports that are reviewed by the group's CEO. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. Inter-segment pricing is determined on an arm's length basis.

	Fixed lease agreements R'000	C-Corp lease agreements R'000	F&V lease agreements R'000	Variable lease segments R'000	Total of all operating segments R'000
Statement of Comprehensive Income – 31 Dec 2010					
Segment revenue	65 609	54 405	5 729	11 296	137 039
Expenditure	–	–	–	–	–
Segment results	65 609	54 405	5 729	11 296	137 039
Statement of Comprehensive Income – 31 Dec 2009					
Segment revenue	69 010	54 335	–	5 181	128 526
Expenditure	–	–	–	–	–
Segment results	69 010	54 335	–	5 181	128 526
Statement of Financial Position – 31 December 2010					
Non-current assets					
Investment properties	1 229 119	1 612 608	231 912	307 843	3 381 482
Current assets					
Trade receivables	701	6 509	1 685	–	8 895
Segment assets	1 229 820	1 619 117	233 597	307 843	3 390 377
Statement of Financial Position – 31 December 2009					
Non-current assets					
Investment properties	1 122 920	1 874 415	290 000	125 368	3 412 703
Current assets					
Trade and other receivables	1 172	5 893	2 697	717	10 479
Segment assets	1 124 092	1 880 308	292 697	126 085	3 423 182

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