



Comments

1 Introduction

While the hotel industry continued to experience extremely challenging trading conditions during the first quarter of the Fund's financial year, the second quarter saw a significant improvement in occupancy levels. According to STR Global, the industry reported a year-on-year increase in occupancy of 5.4% to 59% and a decrease in average room rates ("ARR") of 5.7% to R855 for the six months to December 2011. The previous year comparative is distorted by the effect of the last 11 days of the FIFA World Cup 2010 where trading volumes and rates were significantly boosted by the event. If the month of July is excluded from the comparative, occupancy reflects growth of 6.6% and ARR increases by 2.2%, resulting in a RevPar increase of 9.0%.

The Fund's trading figures for the portion of its portfolio which is subject to variable rental income (i.e. dependant on operational earnings) reflected an increase in occupancy of 9.8% to 57.9% and an increase in ARR of 4.7% to R971 resulting in RevPar growth of 15.0% for the six-month period. The improved trading conditions during the latter part of the period are encouraging and early indications are that this trend appears to be continuing in 2012. The downside risk to this prognosis being worse than expected growth in the South African economy in the face of global economic instability. The challenge facing the Fund is to ensure that optimal growth in ARR's is achieved on the back of improving occupancies within what is still a highly competitive environment.

Hotel owners continue to absorb increases in overhead costs which are currently significantly ahead of inflation. In particular, escalations in administered prices such as electricity, water and municipal rates have had a marked effect on earnings. The Fund has implemented various initiatives to proactively reduce consumption of utilities and actively monitor and manage municipal valuations.

Insofar as the Fund's fixed lease properties are concerned, management continues to be cognisant of the ongoing financial pressures on tenants and constantly monitors and interacts with them in order to understand their underlying business performance and evaluate the serviceability of rentals.

2 Results

Rental income for the period grew by 17.2% mainly as a result of the acquisition of the Arabella portfolio (comprising the Westin – Cape Town and the Arabella Hotel & Spa – Kleinmond) concluded on 13 May 2011. The standing portfolio (i.e. excluding the Arabella portfolio) reflected a decrease in rental income of 3.6%. This was partly due to the previous corresponding period having the last 11 days of the FIFA Soccer World Cup 2010 included, where the Fund reaped the benefits of higher demand.

Additionally, the Western Cape hotels experienced a particularly poor winter trading season. While these properties have since shown strong recovery, it was not sufficient to make up the initial trading deficit. Furthermore, the Courtyard properties have underperformed expectations and the profits from the Courtyard Joint Venture with City Lodge Hotels have been significantly lower than the previous year.

The dispute with the City of Johannesburg highlighted in the year-end financial statements has not yet been resolved. The amount has increased to R13 million and relates to disputed municipal valuations at Crowne Plaza Johannesburg – The Rosebank and Holiday Inn Sandton. The necessary objections and motivations have been lodged and a valuation appeal board hearing date is awaited. Management and the consultants engaged to assist on this matter are optimistic of a successful outcome at the appeal hearing. Fund expenses increased by some R7.6 million mainly due to a bad debt provision of R4.8 million raised in respect of a potential tenant default. Net finance costs increased by R22.8 million due to the additional debt to fund the Arabella acquisition and various capital expenditures on refurbishment projects.

The net effect is that distributable earnings per combined linked unit declined by 27.9% compared to the previous financial year. The A-linked unit distributable amount of 63.35 cents grew by 5%, in line with the Fund's distribution structure, resulting in the distribution on the B-linked unit decreasing by 79.4% to 7.91 cents. This is in line with the trading statement announced on 5 December 2011.

As previously announced in the cautionary of 23 January 2012 and the Notice of General Meeting on 27 February 2012, the refinancing of the Absa Bank Limited ("Absa") loan agreement which expired on 10 February 2012 requires the Fund to undertake a rights issue as part of the refinancing arrangement. Given the current status of the debt refinancing arrangement with Absa being short term (as set out more fully below), any distributions declared by the Fund requires Absa's consent. Absa have instructed the Fund that only 50% of the distributable earnings may be paid out with the balance to be withheld until the Fund provides Absa with proof of irrevocable commitments to follow rights and/or subscriptions for the proposed general issue of linked units for cash and/or underwriting of the proposed rights offer to a combined value of no less than R500 million.

In addition, given the current short-term status of the Absa loan, the board has sought legal advice on whether or not the proposed distribution is governed by section 46 of the Companies Act, 2008 ("the Act"), which provides that a company may not make any proposed distribution to shareholders unless it reasonably appears that the company will satisfy the solvency and liquidity test laid down in the Act immediately after completing the proposed distribution. Having received conflicting opinions in this regard, the board obtained an urgent opinion from Senior Counsel which concluded that, on a *prima facie* basis, distributions on the debenture component of a linked unit fall within the definition of a distribution in section 1 of the Act and, accordingly, are subject to section 46 of the Act.

The solvency and liquidity test laid down in the Act requires that it reasonably appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months following the date of the distribution. Given that the Absa facility needs to be refinanced within the next six months and the refinancing is in turn subject to the successful completion of the capital raising referred to below, the board is of the view that the Fund will only meet this requirement once the conditions set out in paragraph 11 below have been satisfied.

It is important to note that this comes about purely as a consequence of a statutory requirement in terms of the current short-term nature of the Absa debt facility and has nothing to do with the underlying business which is fundamentally sound.

The following table reflects the operating financial results for the period ended 31 December 2011 compared to the corresponding previous period.

Six months to 31 December	2011 (R'000)	2010 (R'000)	Variance (R'000)	Variance (%)
Contractual rental	160 558	137 039	23 519	17.2
Fund expenses	(17 345)	(9 704)	(7 641)	(78.7)
Net finance costs	(79 971)	(57 191)	(22 780)	(39.8)
Profit before debenture interest	63 242	70 144	(6 902)	(9.8)
Recoupment of debenture interest	–	17 534	(17 534)	(100.0)
Debenture interest	(63 242)	(87 678)	(24 436)	(27.9)
Distribution – A-linked unit	(56 225)	(53 548)	2 677	5.0
Distribution – B-linked unit	(7 017)	(34 130)	(27 113)	(79.4)
Distribution – A-linked unit (cents)	63.34	60.33	3.01	5.0
Distribution – B-linked unit (cents)	7.91	38.45	(30.54)	(79.4)
Combined distribution – unit (cents)	71.25	98.78	(27.53)	(27.9)

Note: Above distribution subject to certain conditions outlined herein.

Approximately 67% (2010: 84%) of the Fund's revenue during the year was derived from fixed rentals with CPI-linked escalations and the remaining 33% (2010: 26%) comprised variable rentals which are linked to underlying hotel operational performance. This year-on-year change was a consequence of the new F&V leases being concluded with hotel operators which comprise fixed rentals of approximately 50% of first year budgeted EBITDA and variable rentals of at least 90% of the balance after deducting the fixed rentals.

3 Arabella portfolio

The take-on of the Arabella portfolio on 13 May 2011 went smoothly and the new hotel operators of the Westin Cape Town (being Starwood Hotels and Resorts) and Arabella Hotel & Spa (being Protea Hospitality Group) under their African Pride brand have performed well despite the challenging trading conditions. The Westin with its strategic location adjacent to the Cape Town International Convention Centre, is the largest 5 star hotel in Cape Town and with superb quality of product and service, is expected to provide a strong underpin to the Fund's rental income stream.

The application process for the development rights on the Phase 2 land at Arabella Hotel & Spa is in progress and the Fund expects a response from the relevant authorities by May 2012. Once the development rights have been secured, the Fund will market this development with a view to realising a profit from the sales of residential stands which will be classified as distributable income.

4 Property portfolio

The Fund's portfolio comprises interests in 26 hotel and resort properties in South Africa. As at 31 December 2011 the book value of the portfolio was R4.0 billion. The portfolio is segmented into three lease types, namely, fixed lease properties, fixed and variable leased properties (F&V) and variable lease properties.

Rentals under fixed lease agreements are determined by normal commercial lease terms, with inflation linked annual escalations. F&V lease agreements comprise approximately 50% initial fixed lease rental, with the remainder being a variable rental equivalent to 90% – 98% of the hotel's EBITDA (earnings before interest, tax, depreciation and amortisation) after deducting the fixed lease portion. The F&V lease category now includes the previous C-Corp leases. 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 2011 was R12.61 (excluding deferred taxation), a decrease of 9.6% from 2010 primarily as a consequence of a general write-down in valuations of the standing portfolio. The net asset value assumes payment in due course of the distribution outlined above. The weighted average lease expiry period is 7.69 years.

5 Development and capital projects

The Fund invested a total of R54.7 million to complete various refurbishment projects during the period under review.

Details of the significant refurbishment projects are detailed below:

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 2011 and renewal of cautionary announcement

- Refurbishment of the Protea Hotel Victoria Junction (Cape Town) at a cost of R41 million and the Inn on the Square (Greenmarket Square – Cape Town) at a cost of R35 million were both completed within budget and re-opened on 1 September 2011.

- The refurbishment of the Protea Hotel Hazview was also completed during the period at a cost of R7.5 million.

With the completion of these projects, all F&V lease properties, with the exception of Protea Hotel Hluhluwe & Safaris have been refurbished and will require minimum further capital expenditure in the short term. The high quality of the Fund's properties will provide a solid platform to benefit from improved trading in a recovering market.

6 Debt facilities and rights issue

The group's debt facilities with financial institutions as at 31 December 2011, amounted to R1.95 billion (Absa R1.35 billion and Nedbank R606 million). Total funds withdrawn on these facilities were R1.84 billion resulting in a loan to value (LTV) ratio (total interest bearing liabilities/ investment property value) of 46%. The average cost of borrowings was 8.8% (2011: 8.9%) for the period under review with 56% of the group's borrowings subject to fixed interest rates through interest swap structures.

The Nedbank debt facilities have a five year maturity and expire in 2015 and 2016.

The holders of the company's securities have been advised in recent announcements on the Securities Exchange News Services of the JSE Limited ("SENS") and in the press that Absa and Hospitality have been in negotiations for the past 12 months regarding the refinancing of the Absa facility. Absa initially indicated that they wished to reduce their exposure to the group to around R750 million and to this end, various proposals were discussed between February and November 2011 with a view to achieving this objective, primarily by including other financiers in what was to be a "club loan". To achieve this, proposals were received from other institutions to take-up the balance of the loan but for various reasons, these were withdrawn in late November 2011. Prospective financiers, including Absa at that stage advised that refinancing would be contingent on Hospitality reducing its current gearing levels by undertaking a rights issue to a minimum value of R500 million. The Absa facility expired on 10 February 2012.

The board of the company has resolved to undertake a capital raising during the first half of 2012 by way of a rights offer and a general issue of shares for cash, which rights offer and general issue of shares for cash will not in the aggregate raise more than R600 million. In terms of the company's memorandum of incorporation, read with the JSE Listings Requirements, the company's shareholders may authorise the directors to allot and issue the authorised but unissued securities.

The successful outcome of the rights offer and general issue of shares for cash will:

- reduce Hospitality's debt levels and strengthen its balance sheet;
- reduce the gearing and interest cover ratios to levels acceptable to the board and the company's current and prospective lenders; and
- improve Hospitality's negotiating capacity in its debt refinancing negotiations.

The general authority to directors to issue shares for cash will result in the earlier flow of funds to Hospitality compared to that of the rights offer which will in part reduce the group's interest exposure.

A notice has been sent to unitholders advising that a General Meeting will be held at the Fund's registered office on 28 March 2012 where various resolutions will be proposed to effectively authorise the directors to allot and issue up to 36 000 000 (thirty six million) "A" ordinary shares and up to 36 000 000 (thirty six million) "B" ordinary shares in the authorised but unissued capital of the company for the specific purposes of implementing the above.

In order to deal with the interim financing pre the conclusion of the rights offer process, Absa have proposed a bridge loan facility for a six-month period.

The interest rate on this bridging facility will however be at prime plus 2% which is significantly higher than the current average cost of debt. In addition Absa requires a restructuring fee of 1% per annum on the current loan balance of R1.35 billion to be paid in order to activate this facility effectively amounting to R6.75 million. This increase in margin and fee charge will have a significant effect on the Fund's distribution for the second six month period to 30 June 2012.

The rights offer process is underway and the necessary circular and notices are being prepared. As the Fund has a linked unit structure which does not allow for a disproportionate number of A and B linked units to be issued, a rights offer cannot be implemented unless an underwrite or irrevocable commitments to follow rights are secured for both the A and B linked units. In order to assist unitholders in assessing the rights issue, the Fund will be publishing a detailed two year financial forecast to provide the market with an assessment of the Fund's financial position and future distribution prospects. The forecasts will be included in the rights offer circular and details of the forecast information published on SENS and in the press prior to the publication of the circular. This forecast has been reviewed by the company's external auditors.

With regards to debt funding post the conclusion of the rights offer which is expected towards end May 2012, Hospitality is in negotiation with Absa and other funders to provide term loans totalling R850 million for varying periods. These loans are however subject to approval of the respective institution's credit committees and the successful constitution of a rights offer in the amount of R500 million.

The successful conclusion of the rights offer will result in the Fund's LTV ratio decreasing to around 35% (based on current property valuations) and an interest cover ratio (ICR) of approximately 2.3 times.

The interest swap agreements that were in place with Absa at year-end for R1.04 billion remain unchanged.

7 Unitholders

During the period some 27.9% of the A-linked units and 27.3% of the B-linked units were traded on the JSE Limited.

8 Changes to the composition of the Board

Mr F M Berkeley resigned from the Board on 14 February 2012 to prevent any perceived conflicts of interest in respect of ongoing debt restructure negotiations between Hospitality and Nedbank where Mr Berkeley is currently employed. The Board is most grateful to Mr Berkeley for his valuable leadership and contribution during his tenure as chairman and director. Mr V W C Ross has been appointed as Acting Chairman of the Board and Mrs L de Beer as Acting Chairman of the Audit Committee.

9 Prospects

Recent hotel trading conditions have been encouraging and early signs of a potential recovery across the industry seem evident. Management are focussed on successfully concluding the rights issue and finalising the term loans with the various financial institutions.

Distributions for the six-month period to June 2012 will remain under pressure mainly due to higher Absa short term financing costs and debt restructuring fee. These are however once-off extraneous costs and the Fund is well positioned in the longer term, with its high quality portfolio of assets to benefit from improved trading conditions.

Any reference to future financial performance included in this announcement has not been reviewed and reported on by Hospitality's external auditors and does not constitute an earnings forecast.

10 Renewal of cautionary

Further to the cautionary announcement dated 23 January 2012 and given the status of the refinancing of the Absa facility shareholders are advised to continue exercising caution when dealing in the company's securities until a further announcement is made in this regard.

11 Payments of debenture interest

Unitholders are advised that in applying section 46 as read with section 4 of the Act, Hospitality does not satisfy the solvency and liquidity test as it pertains to the liquidity of the company. In the circumstances, and having regard to the legal advice obtained, the Board is unable at this stage to authorise the distribution payment for the six-month period ended 31 December 2011.

With the Absa bridge loan in place, the Board is of the view that the distribution as set out above can be declared, once the following conditions have been met:

- irrevocable commitments to follow rights and/or subscriptions for the proposed general issue of linked units for cash and/or underwriting of the proposed rights offer to a combined value of no less than R500 million being obtained;
- loan agreements in excess of 12 months being concluded for the balance of the refinancing of the Absa debt; and
- unitholders approving the placing of control of the authorised unissued shares under the control of the directors for purposes of undertaking the rights issue and/or issue of shares for cash.

Given the rights issue timetable, the earliest date by which these conditions are likely to be met is end of March 2012 at which point a further announcement detailing the salient dates of the distribution will be published.

By order of the Board

G A Nelson
(Chief Executive Officer)

6 March 2012

Directors: W C Ross (Acting Chairman)*+, G A Nelson (CEO), K H Abdul-Karim*+, Y Aminzadeh (Dutch)*, R Asmal, L de Beer **+, Z N Kubukeli*+, M B Madunise*+, W J Midgley*, A S Rogers (Deputy CEO) *Non-executive, +Independent

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Statement of comprehensive income

for the six months ended 31 December 2011

	Unaudited Dec 2011 R'000	Unaudited Dec 2010 R'000	Audited June 2011 R'000
Revenue	150 577	137 259	277 358
Rental income – contractual	160 558	137 039	277 043
– straight-line accrual	(9 981)	220	315
Expenditure	(17 345)	(9 704)	(21 051)
Operating expenses	(17 345)	(9 704)	(21 051)
Operating profit	133 232	127 555	256 307
Transaction costs on business combinations	–	–	(16 958)
Net finance cost	(79 971)	(57 191)	(112 857)
Finance income	208	4 339	13 366
Finance costs	(80 179)	(61 530)	(126 223)
Profit before debenture interest, goodwill, fair value adjustments and taxation	53 261	70 364	126 492
Recoupment of debenture interest	–	17 534	17 534
Debenture interest	(63 242)	(87 678)	(160 669)
(Loss)/profit before fair value adjustments, goodwill and taxation	(9 981)	220	(16 643)
Gain on bargain purchase	–	–	141 437
Fair value adjustments	(9 123)	(27 532)	(393 649)
Investment properties, before straight-lining adjustment	–	–	(415 651)
Straight-line rental income accrual	9 981	(220)	(315)
Total fair value of investment properties	9 981	(220)	(415 966)
Contingent consideration	–	–	32 842
Interest-rate swaps	(19 104)	(27 312)	(10 525)
Loss before taxation	(19 104)	(27 312)	(268 855)
Equity accounted profit/(loss) from associate after tax	131	–	(60)
Taxation	–	–	58 195
Total loss and comprehensive loss for the period	(18 973)	(27 312)	(210 720)
Reconciliation between earnings, headline earnings and distributable earnings			
Loss for the period	(18 973)	(27 312)	(210 720)
Adjustments: Debenture interest	63 242	70 144	160 669
Earnings/(loss) (linked units)	44 269	42 832	(50 051)
Adjustments:			
Fair value – investment properties revaluation, net of tax	–	–	357 456
Gain on bargain purchase	–	–	(141 437)
Equity accounted (loss)/profit from associate after tax	(131)	–	60
Fair value – straight line rental income	(9 981)	220	315
Headline earnings (linked units)	34 157	43 052	166 343
Fair value – interest rate swaps	19 104	27 312	10 525
Transaction costs on business combinations	–	–	16 958
Contingent consideration	–	–	(32 842)
Straight line rental income	9 981	(220)	(315)
Distributable earnings	63 242	70 144	160 669
Number of units/shares			
A-linked unit	88 761 391	88 761 391	88 761 391
B-linked unit	88 761 391	88 761 391	88 761 391
Weighted average number of units/shares			
A-linked unit	88 761 391	72 299 806	80 462 949
B-linked unit	88 761 391	72 299 806	80 462 949
Distribution per linked unit (cents)			
A-linked unit	63.34	60.33	122.12
– Interim	63.34	60.33	60.33
– Final	–	–	61.79
B-linked unit	7.91	38.45	58.90
– Interim	7.91	38.45	38.45
– Final	–	–	20.45
	71.25	98.78	181.02

(Loss)/earnings per linked units (cents)			
A-linked unit	24.94	29.62	(31.10)
B-linked unit	24.94	29.62	(31.10)
	49.87	59.24	(62.20)
Headline earnings per linked unit (cents)			
A-linked unit	19.24	29.77	103.37
B-linked unit	19.24	29.77	103.37
	38.48	59.54	206.73
(Loss)/earnings and diluted earnings per ordinary share (cents)	(10.69)	(18.89)	(130.94)

Statement of cash flows

for the six months ended 31 December 2011

	Unaudited Dec 2011 R'000	Unaudited Dec 2010 R'000	Audited June 2011 R'000
Cash flows from operating activities			
Cash generated from operations	118 772	119 873	253 334
Finance income received	208	4 339	13 366
Finance costs paid	(80 179)	(61 530)	(126 223)
Distribution to unitholders	(72 998)	(69 752)	(162 533)
Net cash outflow from operating activities	(34 197)	(7 070)	(22 056)
Cash flows from investing activities			
Acquisition and development of investment properties	(67 932)	(174 012)	(1 000 524)
Acquisition of properties held for sale	(1 008)	–	(16 940)
Acquisition of furniture and equipment	–	(553)	(397)
Investment in associate – Vexicure	60	–	(60)
Net cash outflow from investing activities	(68 880)	(174 565)	(1 017 912)
Cash flows from financing activities			
Proceeds from the issue of linked units	–	577 763	600 402
Share issue expenses paid	–	(11 776)	(11 889)
Interest-bearing liabilities raised	99 518	108 099	431 971
Net cash inflow from financing activities	99 518	674 086	1 020 484
Net increase/(decrease) in cash and cash equivalents	(3 559)	492 451	(19 493)
Cash and cash equivalents at beginning of year	(8 783)	10 710	10 710
Cash and cash equivalents at end of period	(12 342)	503 161	(8 783)

Statement of financial position

as at 31 December 2011

	Unaudited Dec 2011 R'000	Unaudited Dec 2010 R'000	Audited June 2011 R'000
ASSETS			
Non-current assets	4 167 187	3 535 327	4 109 300
Investment properties	4 008 491	3 366 405	3 940 558
Straight-line rent income accrual	5 191	15 077	15 172
Investment properties and related accrual	4 013 682	3 381 482	3 955 730
Furniture and equipment	612	1 023	748
Goodwill	152 822	152 822	152 822
Investment in associate	71	–	–
Current assets	57 849	528 441	57 903