

Huazhu Group Ltd
Form 20-F
April 19, 2019
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report

Commission file number: 001-34656

Huazhu Group Limited

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant's name into English)

CAYMAN ISLANDS

(Jurisdiction of incorporation or organization)

No. 2266 Hongqiao Road

Changning District

Shanghai 200336

People's Republic of China

(86) 21 6195-2011

(Address of principal executive offices)

Min (Jenny) Zhang

Chief Executive Officer

Telephone: +86-21-6076-0606

E-mail: zhangmin@huazhu.com

Facsimile: +86-21-6195-9586

No. 2266 Hongqiao Road

Changning District

Shanghai 200336

People's Republic of China

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
American Depositary Shares, each representing one ordinary share, par value US\$0.0001 per share	NASDAQ Global Select Market

Edgar Filing: Huazhu Group Ltd - Form 20-F

Table of Contents

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

293,501,124 Ordinary Shares.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to

Edgar Filing: Huazhu Group Ltd - Form 20-F

Section 13(a) of the Exchange Act.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued
by the International Accounting Standards Board

Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

Table of Contents

TABLE OF CONTENTS

	Page
<u>CERTAIN CONVENTIONS</u>	1
<u>PART I</u>	2
<u>ITEM 1.</u>	<u><i>IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</i></u>
<u>ITEM 2.</u>	<u><i>OFFER STATISTICS AND EXPECTED TIMETABLE</i></u>
<u>ITEM 3.</u>	<u><i>KEY INFORMATION</i></u>
3.A. Selected Financial Data	2
3.B. Capitalization and Indebtedness	3
3.C. Reason for the Offer and Use of Proceeds	3
3.D. Risk Factors	4
<u>ITEM 4.</u>	<u><i>INFORMATION ON THE COMPANY</i></u>
4.A. History and Development of the Company	27
4.B. Business Overview	29
4.C. Organizational Structure	51
4.D. Property, Plants and Equipment	54
<u>ITEM 4A.</u>	<u><i>UNRESOLVED STAFF COMMENTS</i></u>
<u>ITEM 5.</u>	<u><i>OPERATING AND FINANCIAL REVIEW AND PROSPECTS</i></u>
5.A. Operating Results	54
5.B. Liquidity and Capital Resources	74
5.C. Research and Development, Patents and Licenses, etc.	77
5.D. Trend Information	77
5.E. Off-Balance Sheet Arrangements	78
5.F. Tabular Disclosure of Contractual Obligations	78
5.G. Safe Harbor	79
<u>ITEM 6.</u>	<u><i>DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</i></u>
6.A. Directors and Senior Management	79
6.B. Compensation	82
6.C. Board Practices	84
6.D. Employees	86
6.E. Share Ownership	86
<u>ITEM 7.</u>	<u><i>MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</i></u>
7.A. Major Shareholders	88
7.B. Related Party Transactions	88
7.C. Interests of Experts and Counsel	89
<u>ITEM 8.</u>	<u><i>FINANCIAL INFORMATION</i></u>
8.A. Consolidated Statements and Other Financial Information	90
8.B. Significant Changes	90
<u>ITEM 9.</u>	<u><i>THE OFFER AND LISTING</i></u>
9.A. Offering and Listing Details	91
9.B. Plan of Distribution	91
9.C. Markets	91
9.D. Selling Shareholders	91
9.E. Dilution	91
9.F. Expenses of the Issue	91
<u>ITEM 10.</u>	<u><i>ADDITIONAL INFORMATION</i></u>
10.A. Share Capital	91
10.B. Memorandum and Articles of Association	91
10.C. Material Contracts	91
10.D. Exchange Controls	91
10.E. Taxation	91
10.F. Dividends and Paying Agents	97
10.G. Statement by Experts	97
10.H. Documents on Display	97

Table of Contents

	<u>ITEM 11.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	98
	<u>ITEM 12.</u>	<u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	99
	<u>12.A. Debt Securities</u>		99
	<u>12.B. Warrants and Rights</u>		99
	<u>12.C. Other Securities</u>		99
	<u>12.D. American Depositary Shares</u>		99
<u>PART II</u>			101
	<u>ITEM 13.</u>	<u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	101
	<u>ITEM 14.</u>	<u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	101
	<u>ITEM 15.</u>	<u>CONTROLS AND PROCEDURES</u>	101
	<u>ITEM 16A.</u>	<u>AUDIT COMMITTEE FINANCIAL EXPERT</u>	102
	<u>ITEM 16B.</u>	<u>CODE OF ETHICS</u>	102
	<u>ITEM 16C.</u>	<u>PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	102
	<u>ITEM 16D.</u>	<u>EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u>	103
	<u>ITEM 16E.</u>	<u>PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	103
	<u>ITEM 16F.</u>	<u>CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u>	103
	<u>ITEM 16G.</u>	<u>CORPORATE GOVERNANCE</u>	103
	<u>ITEM 16H.</u>	<u>MINE SAFETY DISCLOSURE</u>	103
<u>PART III</u>			104
	<u>ITEM 17.</u>	<u>FINANCIAL STATEMENTS</u>	104
	<u>ITEM 18.</u>	<u>FINANCIAL STATEMENTS</u>	104
	<u>ITEM 19.</u>	<u>EXHIBITS</u>	104

Table of Contents

CERTAIN CONVENTIONS

Unless otherwise indicated, all translations from U.S. dollars to RMB in this annual report were made at a rate of US\$1.00 to RMB6.8755, the exchange rate as set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2018. No representation is made that the RMB amounts referred to herein could have been or could be converted into U.S. dollars at any particular rate or at all. On April 12, 2019, the exchange rate was US\$1.00 to 6.7039. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.

Unless otherwise indicated, in this annual report,

- *ADRs* are to the American depositary receipts that may evidence our ADSs;
- *ADSs* are to our American depositary shares, each representing one ordinary share;
- *China* or the *PRC* are to the People's Republic of China, excluding, for purposes of this annual report, Hong Kong, Macau and Taiwan;
- *leased hotels* are to leased-and-operated hotels;
- *manachised hotels* are to franchised-and-managed hotels;
- *Ordinary shares* are to our ordinary shares, par value US\$0.0001 per share;
- *RMB* and *Renminbi* are to the legal currency of China;
- *US\$* and *U.S. dollars* are to the legal currency of the United States; and

Edgar Filing: Huazhu Group Ltd - Form 20-F

- *We, us, our company, our* and *Huazhu* are to Huazhu Group Limited, formerly known as China Lodging Group, Limited, a Cayman Islands company, and its predecessor entities and subsidiaries.

All of our ADS related numbers contained in this prospectus have retroactively reflected the four-for-one ADS split that we effected in April 2018.

Since the beginning of 2018, we have adopted the new revenue recognition standards and all numbers for the years ended December 31, 2016 and 2017 in this annual report are restated to reflect the adoption of Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09) using the full retrospective approach as of January 1, 2016. Please see [Item 5. Operating and financial review and prospects](#) [5.A. Operating Results](#) [Critical Accounting Policies](#) [Revenue Recognition](#) for more information.

Table of Contents**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**3.A. Selected Financial Data**

The selected consolidated statements of comprehensive income data and selected consolidated cash flow data for the years ended December 31, 2016, 2017 and 2018 and the selected consolidated balance sheet data as of December 31, 2017 and 2018 are derived from our audited consolidated financial statements included herein, which were prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The selected consolidated statements of comprehensive income data and selected consolidated cash flow data for the years ended December 31, 2014 and 2015 and the selected consolidated balance sheet data as of December 31, 2014, 2015 and 2016 are derived from our audited consolidated financial statements that have not been included herein and were prepared in accordance with U.S. GAAP. The selected financial data set forth below should be read in conjunction with Item 5. Operating and Financial Review and Prospects and the consolidated financial statements and the notes to those statements included herein. The historical results presented below are not necessarily indicative of financial results to be achieved in future periods.

	2014	2015	Year Ended December 31,		2018	
	(RMB)	(RMB)	2016	2017	(RMB)	(US\$)
			(RMB)	(RMB)	(RMB)	
			(In millions, except share, per share and per ADS data)			
Selected Consolidated Statement of Comprehensive Income Data:						
Net revenues	4,965	5,775	6,573	8,229	10,063	1,464
Operating costs and expenses(1)	4,594	5,205	5,715	6,874	7,945	1,155

Edgar Filing: Huazhu Group Ltd - Form 20-F

Income from operations	389	601	841	1,426	2,344	341
Income before income taxes	414	639	1,047	1,597	1,393	203
Net income	302	439	774	1,228	727	106
Net income attributable to Huazhu Group Limited	307	437	782	1,228	716	104
Earnings per share/ADS(2):						
Basic	1.23	1.74	2.84	4.40	2.54	0.37
Diluted	1.21	1.70	2.76	4.21	2.49	0.36
Weighted average number of shares used in computation:						
Basic	248,957,645	250,533,204	275,139,070	279,272,140	281,717,485	281,717,485
Diluted	253,004,204	256,104,167	282,889,494	293,073,978	303,605,809	303,605,809

Notes:

(1) Includes share-based compensation expenses as follows:

	2014 (RMB)	2015 (RMB)	Year Ended December 31, 2016 (RMB) 2017 (RMB)		2018 (RMB)	(US\$)
			(In millions)			
Share-based compensation expenses	32	53	55	66	83	12

(2) In April 2018, we effected a four-for-one ADS split, pursuant to which each of our ADS represents one ordinary share. For the purpose of calculating earnings per ADS, such share split has been retroactively reflected for all periods presented herein.

Edgar Filing: Huazhu Group Ltd - Form 20-F

Table of Contents

The following table presents a summary of our selected consolidated balance sheet data as of December 31, 2014, 2015, 2016, 2017 and 2018:

	2014 (RMB)	2015 (RMB)	As of December 31,		2018 (RMB)	2018 (US\$)
			2016 (RMB)	2017 (RMB)		
(In millions)						
Selected Consolidated Balance Sheet Data:						
Cash and cash equivalents	809	1,238	3,235	3,475	4,262	620
Restricted cash		361	1	481	622	91
Prepaid rent	385	430	446	660	955	139
Property and equipment, net	3,907	3,806	3,710	4,523	5,018	730
Intangible assets, net	105	145	343	1,644	1,834	267
Long- term investments	224	344	1,064	2,362	6,152	895
Goodwill	65	108	172	2,265	2,630	383
Total assets	6,183	7,694	10,071	17,508	23,993	3,490
Accounts payable	641	585	585	766	890	129
Long-term debt				4,922	8,812	1,282
Deferred rent long-term	830	945	1,024	1,380	1,507	219
Deferred revenue	670	886	1,232	1,341	1,463	213
Total liabilities	2,964	4,253	4,887	11,274	17,674	2,571
Total equity	3,219	3,441	5,184	6,234	6,319	919

The following table presents a summary of our selected consolidated statements of cash flow data for the years ended December 31, 2014, 2015, 2016, 2017 and 2018:

	2014 (RMB)	2015 (RMB)	Year Ended December 31,		2018 (RMB)	2018 (US\$)
			2016 (RMB)	2017 (RMB)		
(In millions)						
Selected Consolidated Statement of Cash Flow Data:						
Net cash provided by operating activities	1,466	1,763	2,066	2,453	3,049	444
Net cash used in investing activities	1,063	1,550	176	6,235	6,345	923
Net cash provided by (used in) financing activities	10	219	(266)	4,536	4,248	618

3.B. Capitalization and Indebtedness

Not applicable.

3.C. Reason for the Offer and Use of Proceeds

Not applicable.

Table of Contents

3.D. Risk Factors

Risks Related to Our Business

Our operating results are subject to conditions affecting the lodging industry in general.

Our operating results are subject to conditions typically affecting the lodging industry, which include:

- changes and volatility in national, regional and local economic conditions in China;
- competition from other hotels, the attractiveness of our hotels to customers, and our ability to maintain and increase sales to existing customers and attract new customers;
- adverse weather conditions, natural disasters or travelers' fears of exposure to contagious diseases and social unrest;
- changes in travel patterns or in the desirability of particular locations;
- increases in operating costs and expenses due to inflation and other factors;
- local market conditions such as an oversupply of, or a reduction in demand for, hotel rooms;
- the quality and performance of managers and other employees of our hotels;
- the availability and cost of capital to fund construction and renovation of, and make other investments in, our hotels;

- seasonality of the lodging business and national or regional special events;
- the possibility that leased properties may be subject to challenges as to their compliance with the relevant government regulations; and
- maintenance and infringement of our intellectual property.

Changes in any of these conditions could adversely affect our occupancy rates, average daily rates and revenues generated per available room, or RevPAR, or otherwise adversely affect our results of operations and financial condition.

Our business is sensitive to Chinese and global economic conditions. A severe or prolonged downturn in the Chinese or global economy could materially and adversely affect our revenues and results of operations.

Our business and operations are primarily based in China and we depend on domestic business and leisure traveler customers for a significant majority of our revenues. Accordingly, our financial results have been, and we expect will continue to be, affected by developments in the Chinese economy and travel industry. As the travel industry is highly sensitive to business and personal discretionary spending levels, it tends to decline during general economic downturns. The growth rate of China's GDP decreased from 2012 to 2016 and in 2018. It is uncertain whether the growth of the Chinese economy will continue to slow down in the future. A prolonged slowdown in the Chinese economy could erode consumer confidence which could result in changes to consumer spending patterns for travel and lodging-related products and services.

There is a possibility that China's economic growth rate may materially decline in the near future, which may have adverse effects on our financial condition and results of operations. Risk of a material slowdown in China's economic growth rate is based on several current or emerging factors including: (i) overinvestment by the government and businesses and excessive credit offered by banks; (ii) a rudimentary monetary policy; (iii) excessive privileges to state-owned enterprises at the expense of private enterprises; (iv) the dwindling supply of surplus labor; (v) a decrease in exports due to weaker overseas demand; (vi) failure to boost domestic consumption; and (v) challenges resulted from international situations, especially the US-China trade war.

Table of Contents

The global financial markets experienced significant disruptions in 2008 and the United States, Europe and other economies went into recession. The recovery from the lows of 2008 and 2009 was uneven and it is facing new challenges, including sanctions against Russia over the Ukraine crisis since 2014, shadows of international terrorism spread by Islamic State of Iraq and al-Sham, which has been particularly intensified since the Paris terror attacks in November 2015, the uncertainty associated with the United Kingdom leaving the European Union, or EU, since the referendum in June 2016, the impact of the election of Donald Trump as President of the United States and his tax reform plan, the trade war between the United States and China and the Syrian airstrike in 2018. It is unclear whether such challenges will be contained or resolved and what effects they may have. There is considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world's leading economies, including China's. There have also been concerns over unrest in the Middle East and Africa, which have resulted in significant market volatility, and over the possibility of a war involving Iran or North Korea. In addition, there have been concerns about the economic effect of the earthquake, tsunami and nuclear crisis in Japan and the tensions between Japan and its neighboring countries. Economic conditions in China are sensitive to global economic conditions.

Any prolonged slowdown in the Chinese or global economy may have a negative impact on our business, results of operations and financial condition, and continued turbulence in the international markets may adversely affect our ability to access the capital markets to meet liquidity needs.

The lodging industry in China is competitive, and if we are unable to compete successfully, our financial condition and results of operations may be harmed.

The lodging industry in China is highly fragmented. As a multi-brand hotel group we believe that we compete primarily based on location, room rates, brand recognition, quality of accommodations, geographic coverage, service quality, range of services, guest amenities and convenience of the central reservation system. We primarily compete with other hotel groups as well as various stand-alone lodging facilities in each of the markets in which we operate. Our HanTing Hotels, Orange Hotels, Ibis Hotels and Elan Hotels mainly compete with Home Inns, Jinjiang Inn, 7 Days Inn, various regional hotel groups and stand-alone hotels, and certain international brands such as Super 8 and OYO hotels. HanTing Hotels, Orange Hotels and Ibis Hotels also compete with two- and three-star hotels, as they offer rooms with amenities comparable to many of those hotels. Our JI Hotels, Starway Hotels, Orange Hotels Select, HanTing Premium Hotels, Ibis Styles Hotels, Mercure Hotels and Novotel Hotels face competition from existing three-star and certain four-star hotels, boutique hotels whose price could be comparable and a few hotel chains such as Vienna Hotels, Atour Hotels, Hampton Hotels and Holiday Inn Express. Our Hi Inns compete mainly with stand-alone guest houses, low-price hotels and budget hotel chains such as Pod Inns, 99 Inns and 100 Inns. Our Joya Hotels, Manxin Hotels and Grand Mercure Hotels compete with existing four-star and five-star hotels. Our Manxin Hotels, Crystal Orange Hotels and Blossom Hill Hotels also compete with boutique resort hotels. New and existing competitors may offer more competitive rates, greater convenience, services or amenities or superior facilities, which could attract customers away from our hotels and result in a decrease in occupancy and average daily rates for our hotels. Competitors may also outbid us for new leased hotel conversion sites, negotiate better terms for potential franchised or franchised hotels or offer better terms to our existing franchised or franchised hotel owners, thereby slowing our anticipated pace of expansion. Furthermore, our typical guests may change their travel, spending and consumption patterns and choose to stay in other kinds of hotels, especially given the increase in our hotel room rates to keep pace with inflation. Any of these factors may have an adverse effect on our competitive position, results of operations and financial condition.

Our financial and operating performance may be adversely affected by epidemics, adverse weather conditions, natural disasters and other catastrophes.

Our financial and operating performance may be adversely affected by epidemics, adverse weather conditions, natural disasters and other catastrophes, particularly in locations where we operate a large number of hotels.

Our business could be materially and adversely affected by the outbreak of swine influenza, avian influenza, severe acute respiratory syndrome or other epidemics. In recent years, there have reports on the occurrences of avian influenza in various parts of China, including hundreds of confirmed human deaths. Any prolonged recurrence of such contagious disease or other adverse public health developments in China may have a material and adverse effect on our operations. For example, if any of our employees or customers is suspected of having contracted any contagious disease while he or she has worked or stayed in our hotels, we may under certain circumstances be required to quarantine our employees that are affected and the affected areas of our premises.

Table of Contents

Losses caused by epidemics, adverse weather conditions, natural disasters and other catastrophes, including earthquakes or typhoons, are either uninsurable or too expensive to justify insuring against in China. In the event an uninsured loss or a loss in excess of insured limits occurs, we could lose all or a portion of the capital we have invested in a hotel, as well as the anticipated future revenues from the hotel. In that event, we might nevertheless remain obligated for any financial commitments related to the hotel.

Similarly, war (including the potential of war), terrorist activity (including threats of terrorist activity), social unrest and heightened travel security measures instituted in response, travel-related accidents, as well as geopolitical uncertainty and international conflict, will affect travel and may in turn have a material adverse effect on our business and results of operations. In addition, we may not be adequately prepared in contingency planning or recovery capability in relation to a major incident or crisis, and as a result, our operational continuity may be adversely and materially affected and our reputation may be harmed.

Seasonality of our business and national or regional special events may cause fluctuations in our revenues, cause our ADS price to decline, and adversely affect our profitability

The lodging industry is subject to fluctuations in revenues due to seasonality and national or regional special events. The seasonality of our business may cause fluctuations in our quarterly operating results. Generally, the first quarter, in which both the New Year and Spring Festival holidays fall, accounts for a lower percentage of our annual revenues than other quarters of the year. We typically have a lower RevPAR in the fourth quarter, as compared to the second and third quarters, due to reduced travel activities in the winter. In addition, national or regional special events that attract large numbers of people to travel may also cause fluctuations in our operating results in particular for the hotel locations where those events are held. For example, the 2016 G20 Hangzhou summit led to the decreased occupancy rates for our hotels in Hangzhou in September 2016. The 19th National Congress of the Communist Party of China led to the increased occupancy rates for our hotels in Beijing in October 2017. Therefore, you should not rely on our operating or financial results for prior periods as an indication of our results in any future period. As our revenues may vary from quarter to quarter, our business is difficult to predict and our quarterly results could fall below investor expectations, which could cause our ADS price to decline. Furthermore, the ramp-up process of our new hotels can be delayed during the low season, which may negatively affect our revenues and profitability.

Our relatively limited operating history makes it difficult to evaluate our future prospects and results of operations.

Our operations commenced, through Powerhill Holdings Limited, or Powerhill, with midscale limited service hotels and commercial property development and management in 2005, and we began migrating to our current business of operating and managing a multi-brand hotel group in 2007. See Item 4. Information on the Company A. History and Development of the Company. Accordingly, you should consider our future prospects in light of the risks and challenges encountered by a company with a relatively limited operating history. These risks and challenges include:

- continuing our growth while trying to achieve and maintain our profitability;

- preserving and enhancing our competitive position in the lodging industry in China;
- offering innovative products to attract recurring and new customers;
- implementing our strategy and modifying it from time to time to respond effectively to competition and changes in customer preferences and needs;
- increasing awareness of our brands and products and continuing to develop customer loyalty;
- attracting, training, retaining and motivating qualified personnel; and
- renewing leases for our leased hotels on commercially viable terms after the initial lease terms expire.

If we are unsuccessful in addressing any of these risks or challenges, our business may be materially and adversely affected.

Table of Contents

Our new leased and owned hotels typically incur significant pre-opening expenses during their development stages and generate relatively low revenues during their ramp-up stages, which may have a significant negative impact on our financial performance.

The operation of each of our leased and owned hotel goes through three stages: development, ramp-up and mature operations. During the development stage, leased and owned hotels incur pre-opening expenses generally ranging from approximately RMB2.0 million to RMB20.0 million per hotel. During the ramp-up stage, when the occupancy rate is relatively low, revenues generated by these hotels may be insufficient to cover their operating costs, which are relatively fixed in nature. As a result, these newly opened leased and owned hotels may not achieve profitability during the ramp-up stage. As we continue to expand our leased and owned hotel portfolio, the significant pre-opening expenses incurred during the development stage and the relatively low revenues during the ramp-up stage of our newly opened leased and owned hotels may have a significant negative impact on our financial performance. Moreover, we plan to develop more midscale and upscale leased and owned hotels in the future with relatively higher pre-opening expenses, especially rent, which may lead to a more evident negative impact on our financials.

A significant portion of our costs and expenses may remain constant or increase even if our revenues decline, which would adversely affect our net margins and results of operations.

A significant portion of our operating costs, including rent and depreciation and amortization, is fixed. Accordingly, a decrease in revenues could result in a disproportionately higher decrease in our earnings because our operating costs and expenses are unlikely to decrease proportionately. For example, the New Year and Spring Festival holiday periods generally account for a lower portion of our annual revenues than other periods. However, our expenses do not vary as significantly with changes in occupancy and revenues as we need to continue to pay rent and salary and to make regular repairs, maintenance and renovations and invest in other capital improvements throughout the year to maintain the attractiveness of our hotels. Our property development and renovation costs may increase as a result of increasing costs of materials. However, we have a limited ability to pass increased costs to customers through room rate increases. Therefore, our costs and expenses may remain constant or increase even if our revenues decline, which would adversely affect our net margins and results of operations.

We may not be able to manage our planned growth, which could adversely affect our operating results.

Our hotel group has been growing rapidly since we began migrating to our current business of operating and managing a multi-brand hotel group. In 2007, we launched our economy hotel product, HanTing Express Hotel, which was subsequently rebranded as *HanTing Hotel*, and our midscale limited service hotel product, *HanTing Hotel*, which was subsequently rebranded first as *HanTing Seasons Hotel* and then as *JI Hotel*. In May 2012, we completed the acquisition of a 51% equity interest in Starway Hotels (Hong Kong) Limited, or Starway HK, and in December 2013, we acquired the remaining 49% equity interest of Starway HK from C-Travel. We have retained the *Starway Hotel* brand. In addition, we launched Manxin Hotels & Resorts in October 2013, which was subsequently rebranded as *Manxin Hotel*, *Joya Hotel*, a new hotel brand targeting the upscale market, in December 2013 and *Elan Hotel*, a new economy hotel brand, in September 2014. In January 2016, we completed strategic alliance transactions with Accor S.A. (Accor) to join forces in the Pan-China region to develop Accor brands and to form an extensive and long-term

alliance with Accor. In May 2017, we completed the acquisition of all of the equity interests in Crystal Orange Hotel Holdings Limited (Crystal Orange), which holds hotels under the brands of *Crystal Orange Hotel*, *Orange Hotel Select* and *Orange Hotel*. We launched *HanTing Premium* brand in 2017. In August 2018, we completed the acquisition of 83% equity interest of Blossom Hill Hotel Investment Management (Kunshan) Co., Ltd. (the Blossom Hill), which was engaged in the business of operating and managing hotels under Blossom Hill brands in the upscale market in the PRC. Through such organic growth and acquisitions, we increased the number of our hotels in operation in China from 26 hotels as of January 1, 2007 to 4,230 hotels as of December 31, 2018, and we intend to continue to develop and operate additional hotels in different geographic locations in China and overseas. Such expansions have placed, and will continue to place, substantial demands on our managerial, operational, technological and other resources. Our planned expansion will also require us to maintain the consistency of our products and the quality of our services to ensure that our business does not suffer as a result of any deviations, whether actual or perceived, in our quality standards. In order to manage and support our growth, we must continue to improve our existing operational, administrative and technological systems and our financial and management controls, and recruit, train and retain qualified hotel management personnel as well as other administrative and sales and marketing personnel, particularly as we expand into new markets. We cannot assure you that we will be able to effectively and efficiently manage the growth of our operations, recruit and retain qualified personnel and integrate new hotels into our operations. Any failure to effectively and efficiently manage our expansion may materially and adversely affect our ability to capitalize on new business opportunities, which in turn may have a material adverse effect on our results of operations.

Table of Contents

Expansion into new geographic markets and addition of new hotel products for which we have limited operating experience and brand recognition may present operating and marketing challenges that are different from those we currently encounter in our existing markets. Our expansion within existing markets may cannibalize our existing hotels in those markets and, as a result, negatively affect our overall results of operations. Our inability to anticipate the changing demands that expanding operations will impose on our management and information and operational systems, or our failure to quickly adapt our systems and procedures to the new markets, could result in declines of revenues and increases in expenses or otherwise harm our results of operations and financial condition. Expansion through the introduction of new hotel products or brands may also present operating and marketing challenges. There can be no assurance that any new hotel products or brands we introduce will be well received by our customers and become profitable, and if it becomes profitable, it will be achieved in a timely fashion. If a new product or brand is not well received by our customers, we may not be able to generate sufficient revenue to offset related costs and expenses, and our overall financial performance and condition may be adversely affected.

Our multi-brand business strategy exposes us to potential risks and its execution may divert management attention and resources from our established brand, and if any of the new hotel brands are not well received by the market, we may not be able to generate sufficient revenue to offset related costs and expenses, and our overall financial performance and condition may be adversely affected.

We rebranded our *HanTing Express Hotel* as *HanTing Hotel*, our *HanTing Seasons Hotel* as *Ji Hotel* and our *HanTing Hi Inn* as *Hi Inn* in 2012. In the same year we also acquired the *Starway Hotel* brand. In addition, we launched *Manxin Hotels & Resorts* in October 2013, which was subsequently rebranded as *Manxin Hotel*, *Joya Hotel*, a new hotel brand targeting the upscale market, in December 2013 and *Elan Hotel*, a new economy hotel brand, in September 2014. We acquired *Crystal Orange* in May 2017, which holds hotels under the brands of *Crystal Orange Hotel*, *Orange Hotel Select* and *Orange Hotel*. We launched *HanTing Premium* brand in 2017. In August 2018, we completed the acquisition of *Blossom Hill* which holds hotels under the brand of *Blossom Hill Hotels & Resorts*. We are still in the process of developing the *Elan Hotel*, *Joya Hotel*, *Manxin Hotel*, *Starway Hotel*, *Hi Inn*, *HanTing Premium*, *Crystal Orange Hotel*, *Orange Hotel Select* and *Blossom Hill Hotels & Resorts* brands on top of our established brands of *HanTing Hotel* and *Ji Hotel*. In addition to the hotel brands owned by us, we entered into strategic alliance transactions with Accor in January 2016, and are developing Accor's certain hotel brands in PRC, Taiwan and Mongolia.

We cannot guarantee the size and profitability of the various market segments that each new brand is targeting. The business models of these new brands are not proven and we cannot guarantee that they can generate return comparable to the established *HanTing Hotel* and *Ji Hotel* brands. The process of developing new brands may divert management attention and resources from our established *HanTing Hotel* and *Ji Hotel* brands. We may not be able to find competent management staff to lead and manage the execution of the multi-brand business strategy. If we are unable to successfully execute our multi-brand strategy to target various market segments, we may be unable to generate revenues from these market segments in the amounts and by the times we anticipate, or at all, and our business, competitive position, financial condition and prospects may be adversely affected.

We may not be able to successfully identify, secure and develop in a timely fashion additional hotel properties under the lease and ownership model or develop hotel properties on a timely or cost-efficient manner, which may adversely affect our growth strategy and business.

Edgar Filing: Huazhu Group Ltd - Form 20-F

We plan to open more hotels to grow our business. Under our lease and ownership model, we may not be successful in identifying and leasing or acquiring additional hotel properties at desirable locations and on commercially reasonable terms or at all. Even if we are able to successfully identify and acquire new hotel properties, new hotels may not generate the returns we expect. We may also incur costs in connection with evaluating hotel properties and negotiating with property owners, including properties that we are subsequently unable to lease or own. In addition, we may not be able to develop additional hotel properties in a timely fashion due to construction or regulatory delays. If we fail to successfully identify, secure or develop in a timely fashion additional hotel properties, our ability to execute our growth strategy could be impaired and our business and prospects may be materially and adversely affected.

Table of Contents

We develop all of our leased and owned hotels directly. Our involvement in the development of properties presents a number of risks, including construction delays or cost overruns, which may result in increased project costs or lost revenue. We may be unable to recover development costs we incur for projects that do not reach completion. Properties that we develop could become less attractive due to market saturation or oversupply, and as a result we may not be able to recover development costs at the expected rate, or at all. Furthermore, we may not have available cash to complete projects that we have commenced, or we may be unable to obtain financing for the development of future properties on favorable terms, or at all. If we are unable to successfully manage our hotel development to minimize these risks, our growth strategies and business prospects may be adversely affected.

Our leases could be terminated early, we may not be able to renew our existing leases on commercially reasonable terms and our rents could increase substantially in the future, which could materially and adversely affect our operations.

The lease agreements between our lessors and us typically provide, among other things, that the leases could be terminated under certain legal or factual conditions. If our leases were terminated early, our operation of such properties may be interrupted or discontinued and we may incur costs in relocating our operations to other locations. Furthermore, we may have to pay losses and damages and incur other liabilities to our customers and other vendors due to our default under our contracts. As a result, our business, results of operations and financial condition could be materially and adversely affected.

We plan to retain the operation of our leased hotels upon lease expiration through (i) renewal of existing leases or (ii) execution of franchise agreements with the lessors. We cannot assure you, however, that we will be able to retain our hotel operation on satisfactory terms, or at all. In particular, we may experience an increase in our rent payments and cost of revenues in connection with renegotiating our leases. If we fail to retain our hotel operation on satisfactory terms upon lease expiration, our costs may increase and our profit generated from the hotel operation may decrease in the future. If we are unable to pass the increased costs on to our customers through room rate increases, our operating margins and earnings could decrease and our results of operations could be materially and adversely affected.

We may not be able to successfully compete for franchise agreements and, as a result, we may not be able to achieve our planned growth.

Our growth strategy includes expanding through manachising and franchising, by entering into franchise agreements with our franchisees. We believe that our ability to compete for franchise agreements primarily depends on our brand recognition and reputation, the results of our overall operations in general and the success of the hotels that we currently manachise and franchise. Other competitive factors for franchise agreements include marketing support, capacity of the central reservation channel and the ability to operate hotels cost-effectively. The terms of any new franchise agreements that we obtain also depend on the terms that our competitors offer for those agreements. In addition, if the availability of suitable locations for new properties decreases, or governmental planning or other local regulations change, the supply of suitable properties for our manachise and franchise models could be diminished. If the hotels that we manachise or franchise perform less successfully than those of our competitors or if we are unable to offer terms as favorable as those offered by our competitors, we may not be able to compete effectively for new franchise agreements. As a result, we may not be able to achieve our planned growth and our business and results of operations may be materially and adversely affected.

We may have disputes with our franchisees and they may terminate the franchise agreements with us earlier if the franchised hotels performance is worse than they expected.

We may have disputes with our franchisees with respect to the performance of the franchise agreements. For example, we have in the past closed certain manachised and franchised hotels as a result of disputes with the franchisees regarding our measures to avoid competition between the franchisees, including keeping appropriate distances between the manachised and franchised hotels. In addition, our franchise agreements with franchisees typically provide that the franchise agreements could be terminated under certain circumstances. If franchise agreements are terminated early, we lose the franchise fees and related management fees. Furthermore, we may have to pay losses and damages to our guests, and our brand image may be adversely impacted. As a result, our business and results of operations and financial conditions may be adversely affected by early termination of our franchise agreements.

Table of Contents

We plan to renew our existing franchise agreements upon expiration. However, we may be unable to retain our franchisees on satisfactory terms, or at all. If a significant number of our existing franchise agreements are terminated early or are not renewed on satisfactory terms upon expiration, our revenue and profit may decrease in the future. If we cannot get new franchisees to cover those expired or terminated franchises, our results of operations could be materially and adversely affected.

Acquisitions, financial investment or strategic investment may have an adverse effect on our ability to manage our business and harm our results of operations and financial condition.

If we are presented with appropriate opportunities, we may acquire or invest in businesses or assets. For example, we invested in UBOX International Holdings Co Limited in 2012, in China Quanjude (Group) Co., Ltd. and Beijing GOOAGOO Technology Service Co., Ltd. in 2014, in Homeinns Hotel Group (HMIN), Shanghai Founder Service Co., Ltd. and Beijing Qingpu Tourism Culture Development Co., Ltd. in 2015, in AAPC Hotel Management Limited (AAPC LUB), China Young Professionals Apartment Management Limited, Chengjia (Shanghai) Apartment Management Co., Limited (Cjia) and Shanghai CREATER Industrial Co., Ltd. (CREATER) in 2016, and in Blossom Hill and some securities in the hotel industry in 2017. We completed the acquisition of all of the equity interests in Crystal Orange in May 2017. We entered into a share subscription agreement in September 2017 with Oravel Stays Private Ltd. (OYO), where we agreed to make a US\$10 million equity investment in OYO to become a minority shareholder (less than 5%). In January 2018, we announced we have formed a joint venture with TPG. Hitone later also invested in this joint venture. In August 2018, we completed the acquisition of in aggregate 83% of the equity interests in Blossom Hill in steps. In 2017 to 2018, we also acquired shares of Accor and other companies from open market, and invested in certain hotel related funds.

The existing and future acquisitions or investments may expose us to potential risks, including risks associated with unforeseen or hidden liabilities, risks that acquired or invested companies will not achieve anticipated performance levels, diversion of management attention and resources from our existing business, difficulty in integrating the acquired businesses with our existing operational infrastructure, and inability to generate sufficient revenues to offset the costs and expenses of acquisitions or investments. In addition, following completion of an acquisition or investment, our management and resources may be diverted from their core business activities due to the integration process, which diversion may harm the effective management of our business. Furthermore, it may not be possible to achieve the expected level of benefits after integration and the actual cost of delivering such benefits may exceed the anticipated cost. Any difficulties encountered in the acquisition or investment and integration process may have an adverse effect on our ability to manage our business and harm our results of operations and financial condition. If a financial or strategic investment is unsuccessful, then in addition to the diversion of management attention and resources from our existing business we may lose the value of our investment, which could have a material adverse effect on our financial condition and results of operations. For example, we incurred unrealized loss from fair value changes of equity securities totaled RMB914 million (US\$133 million) in 2018.

Our legal right to lease certain properties could be challenged or affected adversely by property owners or other third parties or subject to government regulation.

A substantial part of our business model relies on leases with third parties who either own or lease the properties from the ultimate property owners. We also grant franchises to hotel operators who may or may not own their hotel properties. The land use rights and other property rights with respect to properties we currently lease, manachise or franchise for our existing hotels could be challenged. For example, as of December 31, 2018, our lessors failed to provide the property ownership certificates and/or the land use rights certificates for 100 properties that we lease for our hotel operations. While we have performed due diligence to verify

the rights of our lessors to lease such properties, including inspecting documentation issued by competent government authorities evidencing these lessors' land use rights and other property rights with respect to these properties, our rights under those leases could be challenged by other parties including government authorities. We also cannot assure you that we can always keep good title of the properties we lease currently or will lease in the future, free and clear of all liens, encumbrances and defects before the lease agreements are terminated. If the ultimate owner of the property changes after the original owner of such property mortgages such property to any third party, our legal rights under the lease agreement may be affected adversely and we may not rank senior in the right of continuing occupying the property.

Table of Contents

Under PRC law, all lease agreements are required to be registered with the local housing bureau. While the majority of our standard lease agreements require the lessors to make such registrations, some of our leases have not been registered as required, which may expose both our lessors and us to potential monetary fines. Some of our rights under the unregistered leases may also be subordinated to the rights of other interested third parties. In addition, in several instances where our immediate lessors are not the ultimate owners of hotel properties, no consents or permits were obtained from the owners, the primary lease holders or competent government authorities, as applicable, for the subleases of the hotel properties to us, which could potentially invalidate our leases or lead to the renegotiation of such leases that result in terms less favorable to us. Some of the properties we lease from third parties were also subject to mortgages at the time the leases were signed. Where consent to the lease was not obtained from the mortgage holder in such circumstances, the lease may not be binding on the transferee of the property if the mortgage holder forecloses on the mortgage and transfers the property. Moreover, the property ownership or leasehold in connection with our manachised and franchised hotels could be subject to similar third-party challenges.

Any challenge to our legal rights to the properties used for our hotel operations, if successful, could impair the development or operations of our hotels in such properties. We are also subject to the risk of potential disputes with property owners or third parties who otherwise have rights to or interests in our hotel properties. Such disputes, whether resolved in our favor or not, may divert management's attention, harm our reputation or otherwise disrupt our business.

Any failure to comply with land- and property-related PRC laws and regulations may negatively affect our ability to operate our hotels and we may suffer significant losses as a result.

Our lessors are required to comply with various land- and property-related laws and regulations to enable them to lease effective titles of their properties for our hotel use. For example, properties used for hotel operations and the underlying land should be approved for commercial use purposes by competent government authorities. In addition, before any properties located on state-owned land with allocated or leased land use rights or on land owned by collective organizations may be leased to third parties, lessors should obtain appropriate approvals from the competent government authorities. As of December 31, 2018, the lessors of approximately 33% of our executed lease agreements subject to this approval requirement did not obtain the required governmental approvals. Such failure may subject the lessors or us to monetary fines or other penalties and may lead to the invalidation or termination of our leases by competent government authorities, and therefore may adversely affect our ability to operate our leased hotels. While many of our lessors have agreed to indemnify us against our losses resulting from their failure to obtain the required approvals, we cannot assure you that we will be able to successfully enforce such indemnification obligations against our lessors. As a result, we may suffer significant losses resulting from our lessors' failure to obtain required approvals to the extent that we are not fully indemnified by our lessors.

Our success could be adversely affected by the performance of our manachised and franchised hotels and defaults or wrongdoings of our franchisees may affect our reputation, which would adversely affect the results of our operations.

Our success could be adversely affected by the performance of our manachised and franchised hotels, over which we have less control compared to our leased and owned hotels. As of December 31, 2018, we manachised and franchised approximately 83.5% of our hotels, and we plan to further increase the number of manachised and franchised hotels to increase our national presence in China. Our franchisees for both our manachised and franchised hotels may not be able to develop hotel properties on a timely basis, which could adversely affect our growth strategy and may impact

our ability to collect fees from them on a timely basis. Furthermore, given that our franchisees are typically responsible for the costs of developing and operating the hotels, including renovating the hotels to our standards, and all of the operating expenses, the quality of our manachised and franchised hotel operations may be diminished by factors beyond our control.

Our franchisees may not successfully operate hotels in a manner consistent with our standards and requirements. Our manachised and franchised hotels are also operated under our brand names. If our brands are misused by any of our franchisees, there may be an adverse impact on our business reputation and brand image. In addition, like any operators in service-oriented industries, we are subject to customer complaints and we may face complaints from unsatisfied customers who are unhappy with the standard of service offered by our franchisees. Any complaints, regardless of their nature and validity, may affect our reputation, thereby adversely affecting the results of our operations. We may also have to incur additional costs in placating any customers or salvaging our reputation. For example, in 2018, we closed 60 manachised and franchised hotels that did not comply with our brand and operating standards.

Table of Contents

If any of our franchisees defaults or commits wrongdoing, there could be situations where the franchisee is not in a position to sufficiently compensate us for losses which we have suffered as a result of such defaults or wrongdoings. While we ultimately can take action to terminate our franchisees that do not comply with the terms of our franchise agreements or commit wrongdoing, we may not be able to identify problems and make timely responses and, as a result, our image and reputation may suffer, which may have a material adverse effect on our results of operations.

If we are unable to access funds to maintain our hotels' condition and appearance, or if our franchisees fail to make investments necessary to maintain or improve their properties, the attractiveness of our hotels and our reputation could suffer and our hotel occupancy rates may decline.

In order to maintain our hotels' condition and appearance, ongoing renovations and other leasehold improvements, including periodic replacement of furniture, fixtures and equipment, are required. In particular, we manage and franchise properties leased or owned by franchisees under the terms of franchise agreements, substantially all of which require our franchisees to comply with standards that are essential to maintaining the relevant product integrity and our reputation. We depend on our franchisees to comply with these requirements by maintaining and improving properties through investments, including investments in furniture, fixtures, amenities and personnel.

Such investments and expenditures require ongoing funding and, to the extent we or our franchisees cannot fund these expenditures from existing cash or cash flow generated from operations, we or our franchisees must borrow or raise capital through financing. We or our franchisees may not be able to access capital and our franchisees may be unwilling to spend available capital when necessary, even if required by the terms of our franchise agreements. If we or our franchisees fail to make investments necessary to maintain or improve the properties, our hotels' attractiveness and reputation could suffer, we could lose market share to our competitors and our hotel occupancy rates and RevPAR may decline.

Interruption or failure of our information systems or our business partners' systems could impair our ability to effectively provide our services, which could damage our reputation and subject us to penalties.

Our ability to provide consistent and high-quality services and to monitor our operations on a real-time basis throughout our hotel group depends on the continued operation of our information technology systems, including our web property management, central reservation and customer relationship management systems. Certain damage to or failure of our systems could interrupt our inventory management, affect the manner of our services in terms of efficiency, consistency and quality, and reduce our customer satisfaction.

Our technology platform plays a central role in our management of inventory, revenues, loyalty program and franchisees. We also rely on our website, call center and mobile application to facilitate customer reservations. Our systems remain vulnerable to damage or interruption as a result of power loss, telecommunications failures, computer viruses, fires, floods, earthquakes, interruptions in access to our toll-free numbers, hacking or other attempts to harm our systems, and other similar events. Our servers, which are maintained in Shanghai, may also be vulnerable to break-ins, sabotage and vandalism. Some of our systems are not fully redundant, and our disaster recovery planning does not account for all possible scenarios.

Furthermore, our systems and technologies, including our website and database, could contain undetected errors or bugs that could adversely affect their performance, or could become outdated and we may not be able to replace or introduce upgraded systems as quickly as our competitors or within budgeted costs for such upgrades. If we experience frequent, prolonged or persistent system failures, our quality of services, customer satisfaction, and operational efficiency could be severely harmed, which could also adversely affect our reputation. Steps we take to increase the reliability and redundancy of our systems may be costly, which could reduce our operating margin, and there can be no assurance that whatever increased reliability may be achievable in practice or would justify the costs incurred.

In addition, we collaborate with various business partners, such as airlines, in our day-to-day operations, and our ability to provide satisfactory services to customers also depend on the maintenance and efficacy of such business partners' systems, such as the maintenance of networks with necessary speed, bandwidth, and stability. If any of our business partners' systems encounter errors, bugs or other problems, our ability to effectively provide our services may be adversely affected, our reputation may be harmed, and we may also face customer complaints and be subject to fines and other penalties from competent authorities.

Table of Contents

Failure to maintain the integrity of internal or customer data could result in harm to our reputation or subject us to costs, liabilities, fines or lawsuits.

Our business involves collecting and retaining large volumes of internal and customer data, including credit card numbers and other personal information as our various information technology systems enter, process, summarize and report such data. We also maintain information about various aspects of our operations as well as regarding our employees. The integrity and protection of our customer, employee and company data is critical to our business. Our customers and employees expect that we will adequately protect their personal information. We are required by applicable laws to keep strictly confidential of the personal information that we collect, and to take adequate security measures to safeguard such information.

The Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (general data protection regulation, GDPR), imposes certain requirements on the processing of personal data relating to natural persons. GDPR requirements will apply both to companies established in the EU and to companies, such as us, that are not established in the EU but process personal data of individuals who are in the EU (and in the European Economic Area subject to the enactment of implementation procedures), where the processing activities relate to: (a) the offering of goods or services, irrespective of whether a payment of the data subject is required, to such data subjects in the EU; or (b) the monitoring of their behavior as far as their behavior takes place within the EU. See item 4. Information on the Company 4.B. Business Overview - Regulation - Regulation on Information Protection on Networks. Compliance with the GDPR will be a rigorous and time-intensive process that may increase our cost of doing business, and the failure to comply with the GDPR could expose us to sanctions from both a financial and business operations perspective. In addition, in case of control, non-compliance with the GDPR may expose us to damage to our reputation.

On February 1, 2013, China's first set of personal data protection guidelines, the Guidelines for Personal Information Protection in Information Security Technology Public and Commercial Service Systems, came into effect, which set forth detailed personal information protection requirements on data collection, data processing, data transfer and data creation. Although these guidelines are voluntary and non-binding, we believe that growing regulatory oversight of data privacy in China is inevitable. In addition, Amendment 7 to the PRC Criminal Law prohibits institutions, companies and their employees in the telecommunications and other industries from selling or otherwise illegally disclosing a citizen's personal information obtained during the course of performing duties or providing services or obtaining such information through theft or other illegal ways. On November 7, 2016, the Standing Committee of the PRC National People's Congress issued the Cyber Security Law of the PRC, which became effective on June 1, 2017. Pursuant to the Cyber Security Law of the PRC, providers of network products and services shall provide security maintenance for their products and services and shall comply with provisions regarding the protection of personal information as stipulated under the relevant laws and regulations. Moreover, the Provisions on Protection of Personal Information of Telecommunication and Internet Users is the specific regulation governing the collection, use, disclosure and security of personal information. Complying with these PRC laws and regulations may cause us to incur substantial costs or require us to change our business practices. See Item 4. Information on the Company B. Business Overview Regulation Regulation on Information Protection on Networks .

While we take various measures to comply with all applicable data privacy and protection laws and regulations, our current security measures and those of our third-party service providers may not be adequate for the protection of our customer, employee or company data. In addition, computer hackers, foreign governments or cyber terrorists may attempt to penetrate our network security and our website. Unauthorized access to our proprietary internal and customer data may be obtained through break-ins, sabotage, breach of our secure network by an unauthorized party, computer viruses, computer denial-of-service attacks, employee theft or misuse, breach of the security of the networks of our third-party service providers, or other misconduct. Because the techniques used by computer programmers who may attempt to penetrate and sabotage our

proprietary internal and customer data change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. Unauthorized access to our proprietary internal and customer data may also be obtained through inadequate use of security controls. For instance, in August 2018, online reports alleged that we had become the subject of potential information leak. A proposed class action complaint was filed in the United States District Court in the Central District of California against us and our management alleging violations of the U.S. securities laws in relation to this possible data breach. This case was voluntarily dismissed by the plaintiffs on February 27, 2019. We may face similar litigations in the future. Any of such proceedings may harm our reputation and adversely affect our business and results of operations. The laws and regulations applicable to security and privacy are becoming increasingly important in China. Any theft, loss, fraudulent, unlawful use or disclosure of customer, employee or company data could harm our reputation or result in remedial and other costs, liabilities, fines or lawsuits.

Table of Contents

If the value of our brand or image diminishes, it could have a material and adverse effect on our business and results of operations.

We offer multiple hotel products that are designed to target distinct segments of customers. Our continued success in maintaining and enhancing our brands and image depends, to a large extent, on our ability to satisfy customer needs by further developing and maintaining our innovative and distinctive products and maintaining consistent quality of services across our hotel group, as well as our ability to respond to competitive pressures. If we are unable to do so, our occupancy rates may decline, which could in turn adversely affect our results of operations. Our business may also be adversely affected if our public image or reputation were to be diminished by the operations of any of our hotels, whether due to unsatisfactory service, accidents or otherwise. If the value of our products or image is diminished or if our products do not continue to be attractive to customers, our business and results of operations may be materially and adversely affected.

Failure to protect our trademarks and other intellectual property rights could have a negative impact on our brands and adversely affect our business.

The success of our business depends in part upon our continued ability to use our brands, trade names and trademarks to increase brand awareness and to further develop our products. The unauthorized reproduction of our trademarks could diminish the value of our brands and their market acceptance, competitive advantages or goodwill. In addition, we consider our proprietary information systems and operational system to be key components of our competitive advantage and our growth strategy. As of December 31, 2018, we have received copyright registration certificates for 63 of our major proprietary information systems and for our operating system. However, none of our other proprietary information system have been patented, copyrighted or otherwise registered as our intellectual property.

Monitoring and preventing the unauthorized use of our intellectual property is difficult. The measures we take to protect our brands, trade names, trademarks and other intellectual property rights may not be adequate to prevent their unauthorized use by third parties. Furthermore, the application of laws governing intellectual property rights in China and abroad is evolving and could involve substantial risks to us. In particular, the laws and enforcement procedures in the PRC are uncertain and do not protect intellectual property rights to the same extent as do the laws and enforcement procedures in the United States and other developed countries. If we are unable to adequately protect our brands, trade names, trademarks and other intellectual property rights, we may lose these rights and our business may suffer materially.

We may also be subject to claims for infringement, invalidity, or indemnification relating to third parties' intellectual property rights. Such third party claims may be time-consuming and costly to defend, divert management attention and resources, or require us to enter into licensing agreements, which may not be available on commercially reasonable terms, or at all.

If we are not able to retain, hire and train qualified managerial and other employees, our business may be materially and adversely affected.

Edgar Filing: Huazhu Group Ltd - Form 20-F

Our managerial and other employees manage our hotels and interact with our customers on a daily basis. They are critical to maintaining the quality and consistency of our services as well as our established brands and reputation. In general, employee turnover, especially in lower-level positions, is relatively high in the lodging industry. As a result, it is important for us to retain as well as attract qualified managerial and other employees who are experienced in lodging or other consumer-service industries. There is a limited supply of such qualified individuals in some of the cities in China where we have operations and other cities into which we intend to expand. In addition, we need to hire qualified managerial and other employees on a timely basis to keep pace with our rapid growth while maintaining consistent quality of services across our hotels in various geographic locations. We must also provide training to our managerial and other employees so that they have up-to-date knowledge of various aspects of our hotel operations and can meet our demand for high-quality services. If we fail to do so, the quality of our services may decrease, which in turn, may have a material and adverse effect on our business.

Table of Contents

Our current employment practices may be adversely impacted under the labor contract law of the PRC.

The PRC National People's Congress promulgated the labor contract law in 2008, and amended it on December 28, 2012. The labor contract law imposes requirements concerning, among others, the execution of written contracts between employers and employees, the time limits for probationary periods, and the length of fixed-term employment contracts. Because the PRC governmental authorities have introduced various new labor-related regulations since the effectiveness of the labor contract law, and the interpretation and implementation of these regulations are still evolving, our employment practices could violate the labor contract law and related regulations and could be subject to related penalties, fines or legal fees. If we are subject to severe penalties or incur significant legal fees in connection with labor law disputes or investigations, our business, financial condition and results of operations may be adversely affected. In addition, a significant number of our employees are dispatched from third-party human resources companies, which are responsible for managing, among others, payrolls, social insurance contributions and local residency permits of these employees. According to a new regulation on labor dispatch, which was promulgated in December 2013 to implement the provisions of the labor contract law, a company is permitted to use dispatched employees for only up to 10% of its labor force after February 29, 2016. To comply with the labor dispatch regulation, we have reduced the percentage of dispatched employees since December 2013 by using service outsourcing arrangement. Under the service outsourcing arrangement, we have entered into service outsourcing agreements with a service outsourcing firm and relevant employees are deemed as employees of this service outsourcing firm. However, since the current labor dispatch regulation does not clearly define the distinction of labor dispatch and service outsourcing, our service outsourcing arrangement may be considered as labor dispatch by the relevant PRC government.

In addition, according to the Labor Contract Law and its implementing rules, if we intend to enforce the non-compete provision with our employees in the employment contracts or confidentiality agreements, we have to compensate our employees on a monthly basis during the term of the restriction period after the termination or ending of the employment contract, which may cause extra expenses to us.

Failure to retain our management team could harm our business.

We place substantial reliance on the experience and the institutional knowledge of members of our current management team. Mr. Qi Ji, our founder and executive chairman, Ms. Min (Jenny) Zhang, our chief executive officer, and other members of the management team are particularly important to our future success due to their substantial experiences in lodging and other consumer-service industries. Finding suitable replacements for Mr. Qi Ji, Ms. Min (Jenny) Zhang and other members of our management team could be difficult, and competition for such personnel of similar experience is intense. The loss of the services of one or more members of our management team due to their departures or otherwise could hinder our ability to effectively manage our business and implement our growth strategies.

We are subject to various laws and regulations, including franchise, hotel industry, construction, hygiene, health and safety environmental and advertising laws and regulations that may subject us to liability.

Our business is subject to various compliance and operational requirements under PRC laws. For example, we are required to obtain the approval from, and file initial and annual reports with, the PRC Ministry of Commerce, or the MOC, to engage in the hotel franchising business. In addition, each of our hotels is required to obtain a special industry license and a fire control approval issued by the local public security bureau, to have hotel operations included in the business scope of its business license, to obtain hygiene

permits and environmental impact assessment approvals, and to comply with license requirements and laws and regulations with respect to construction permit, zoning, fire prevention, public area hygiene, food safety, public safety and environmental protection. We are also subject to advertising and other laws and regulations. See Item 4. Information on the Company B. Business Overview Regulation Regulations on Hotel Operation. If we fail to comply with any applicable construction, hygiene, health and safety, environmental and advertising laws and regulations related to our business, we may be subject to potentially significant monetary damages and fines or the suspension of our operations or development activities. Furthermore, new regulations could also require us to retrofit or modify our hotels or incur other significant expenses.

Table of Contents

New zoning plans or regulations applicable to a specific location may cause us to relocate our hotel(s) in that location, or require additional approvals and licenses that may not be granted to us promptly or at all, which may adversely affect our operating results. Any failure by us to control the use of, or to adequately restrict the discharge of, hazardous substances in our development activities, or to otherwise operate in compliance with environmental laws could also subject us to potentially significant monetary damages and fines or the suspension of our hotel development activities or hotel operations, which could materially adversely affect our financial condition and results of operations. Some of our hotels are not in full compliance with all of the applicable requirements. Such failure to comply with applicable construction permit, environmental, health and safety laws and regulations related to our business and hotel operation may subject us to potentially significant monetary damages and fines or the suspension of operations and development activities of our company or related hotels. We could be subject to any challenges or other actions with respect to such noncompliance.

Owners of our manachised and franchised hotels are subject to these same permit and safety requirements. Although our franchise agreements require these owners to obtain and maintain all required permits or licenses, we have limited control over these owners. Any failure to obtain and maintain the required permits or licenses by any owner of a manachised or franchised hotel may require us to delay opening of the manachised or franchised hotel or to forgo or terminate our franchise agreement, which could harm our brand, result in lost revenues and subject us to potential indirect liability.

Our limited insurance coverage may expose us to losses, which may have a material adverse effect on our reputation, business, financial condition and results of operations.

We carry all mandatory and certain optional commercial insurance, including property, business interruption, construction, third-party liability, public liability, product s liability and employer s liability insurance for our leased and owned hotel operations. We also require our lessors and franchisees to purchase customary insurance policies. Although we are able to require our franchisees to obtain the requisite insurance coverage through our franchisees management, we cannot guarantee that our lessors will adhere to such requirements. In particular, there are inherent risks of accidents or injuries in hotels. One or more accidents or injuries at any of our hotels could adversely affect our safety reputation among customers and potential customers, decrease our overall occupancy rates and increase our costs by requiring us to take additional measures to make our safety precautions even more visible and effective. In the future, we may be unable to renew our insurance policies or obtain new insurance policies without increases in cost or decreases in coverage levels. We may also encounter disputes with insurance providers regarding payments of claims that we believe are covered under our policies. Furthermore, if we are held liable for amounts and claims exceeding the limits of our insurance coverage or outside the scope of our insurance coverage, our reputation, business, financial condition and results of operations may be materially and adversely affected.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud.

We are subject to reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, adopted rules requiring every public company to include in its annual report a management report on such company s internal control over financial reporting containing management s assessment of the effectiveness of its internal control over financial reporting. In addition, an independent registered public accounting firm must attest to and report on the effectiveness of such company s internal control over financial reporting except where the company is a non-accelerated filer. We currently are a large accelerated filer.

In connection with the preparation of this annual report, we carried out an evaluation of the effectiveness of our internal control over financial reporting. Our management excluded Blossom Hill from our assessment of the internal control over financial reporting, which was acquired on August 31, 2018 and whose financial statements constitute 2.6% and 1.2% of net assets and total assets, respectively, 0.3% of revenues and negative 2.0% of net income of our consolidated financial statement amounts as of and for the year ended December 31, 2018. Based on this assessment and evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2018. See Item 15. Controls and Procedures. Our independent registered public accounting firm has issued an attestation report as of December 31, 2018. See Item 15. Controls and Procedures Attestation Report of the Registered Public Accounting Firm. However, if we fail to maintain effective internal control over financial reporting in the future, our management and our independent registered public accounting firm may not be able to conclude that we have effective internal control over financial reporting. This could in turn result in the loss of investor confidence in the reliability of our financial statements and negatively impact the trading price of our ADSs. Furthermore, we have incurred and anticipate that we will continue to incur considerable costs, management time and other resources in an effort to continue to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

Table of Contents

We may not be able to develop hotel properties on a timely or cost-efficient basis, which may adversely affect our growth strategy and business.

We develop all of our leased and owned hotels directly. Our involvement in the development of properties presents a number of risks, including construction delays or cost overruns, which may result in increased project costs or forgone revenue. We may be unable to recover development costs we incur for projects that do not reach completion. Properties that we develop could become less attractive due to market saturation or oversupply, and as a result we may not be able to recover development costs at the expected rate, or at all. Furthermore, we may not have available cash to complete projects that we have commenced, or we may be unable to obtain financing for the development of future properties on favorable terms, or at all. If we are unable to successfully manage our hotel development to minimize these risks, our growth strategy and business prospects may be adversely affected.

We, our directors, management and employees may be subject to certain risks related to legal proceedings filed by or against us, and adverse results may harm our business.

We cannot predict with certainty the cost of defense, the cost of prosecution or the ultimate outcome of litigation and other proceedings filed by or against us, our directors, management or employees, including remedies or damage awards, and adverse results in such litigation and other proceedings may harm our business or reputation. Such litigation and other proceedings may include, but are not limited to, actions relating to intellectual property, commercial arrangements, leased properties, share transfer, employment, non-competition and labor law, fiduciary duties, personal injury, death, property damage or other harm resulting from acts or omissions by individuals or entities outside of our control, including franchisees and third-party property owners. For example, our PRC subsidiary, Huazhu Hotel Management Co., Ltd., has filed an arbitration against four third parties in China for a share transfer agreement entered into in October 2015, alleging breach of agreement of those third parties and requesting share transfer consideration adjustment and indemnification. The case is currently pending before the arbitration tribunal. In addition, a proposed class action was filed against us and our management with the United States District Court in the Central District of California in October 2018, alleging violations of U.S. securities laws in relation to a possible data breach in August 2018. This case was voluntarily dismissed by the plaintiffs on February 27, 2019. Moreover, in the case of intellectual property litigation and proceedings, adverse outcomes could include the cancellation, invalidation or other loss of material intellectual property rights used in our business and injunctions prohibiting our use of business processes or technology that is subject to third-party patents or other third-party intellectual property rights.

We generally are not liable for the willful actions of our franchisees and property owners; however, there is no assurance that we would be insulated from liability in all cases.

Risks Related to Doing Business in China

Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

We conduct substantially all of our operations in China. As the lodging industry is highly sensitive to business and personal discretionary spending levels, it tends to decline during general economic downturns. Accordingly, our results of operations, financial condition and prospects are subject to a significant degree to economic developments in China. China's economy differs from the economies of most developed countries in many respects, including with respect to the amount and degree of government involvement and influence on the level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past over 30 years, growth has been uneven across different regions and among various economic sectors of China. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. While some of these measures benefit the overall PRC economy, they may also have a negative effect on us. For example, our results of operations and financial condition may be adversely affected by government control over capital investments or changes in environmental, health, labor or tax regulations that are applicable to us.

Table of Contents

As the PRC economy is increasingly intricately linked to the global economy, it is affected in various respects by downturns and recessions of major economies around the world, such as the global financial crisis and sovereign debt crisis in Europe. Stimulus measures designed to help China weather the global financial crisis may contribute to higher inflation, which could adversely affect our results of operations and financial condition. For example, certain operating costs and expenses, such as employee compensation and hotel operating expenses, may increase as a result of higher inflation. Measures to control the pace of economic growth may cause a decrease in the level of economic activity in China, which in turn could adversely affect our results of operations and financial condition. The PRC economy has been transitioning from a planned economy to a more market-oriented economy. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies.

The PRC government also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Certain measures adopted by the PRC government, such as changes of the People's Bank of China's statutory deposit reserve ratio and lending guideline imposed on commercial banks, may restrict loans to certain industries. The State Administration of Foreign Exchange, or SAFE, and the relevant Chinese banks where our operating subsidiaries in China opened bank accounts may adopt restrictions on the cross-border payment obligations and dividends repatriation made by these subsidiaries by way of window guidance measures. These actions, as well as future actions and policies of the PRC government, could materially affect our liquidity and access to capital and our ability to operate our business.

Inflation in China may disrupt our business and have an adverse effect on our financial condition and results of operations.

The Chinese economy has experienced rapid expansion together with rising rates of inflation and increasing salaries. Salary increases could potentially increase discretionary spending on travel, but general inflation may also erode disposable incomes and consumer spending. Furthermore, certain components of our operating costs, including personnel, food, laundry, consumables and property development and renovation costs, may increase as a result of an increase in the cost of materials and labor resulting from general inflation. However, we cannot guarantee that we can pass increased costs to customers through room rate increases. This could adversely impact our business, financial condition and results of operations.

Uncertainties with respect to the Chinese legal system could limit the legal protections available to us and our investors and have a material adverse effect on our business and results of operations.

The PRC legal system is a civil law system based on written statutes. Unlike in common law systems, prior court decisions may be cited for reference but have limited precedential value. Since the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involves uncertainties, which may limit legal protections available to us. For example, we may have to resort to administrative and court proceedings to enforce the legal protection that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult than in more developed legal systems to evaluate the outcomes of administrative and court proceedings and the level of legal protection we enjoy. These uncertainties may impede our ability to enforce the contracts we have entered into. In addition, such uncertainties, including the inability to enforce our contracts, could materially and adversely

affect our business. Accordingly, we cannot predict the effect of future developments in the PRC legal system, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, any litigation in China may be protracted and result in substantial costs and diversion of our resources and management attention.

Table of Contents

Rapid urbanization and changes in zoning and urban planning in China may cause our leased and owned hotels to be demolished, removed or otherwise affected and our franchise agreements to terminate.

China is undergoing a rapid urbanization process, and zoning requirements and other governmental mandates with respect to urban planning of a particular area may change from time to time. When there is a change in zoning requirements or other governmental mandates with respect to the areas where our hotels are located, the affected hotels may need to be demolished or removed. We have experienced such demolition and relocation in the past and we may encounter additional demolition and relocation cases in the future. For example, in 2018, we were obligated to demolish one leased hotel due to local government zoning requirements. As a result, we wrote off property and equipment of RMB8 million associated with the hotels and recognized a loss of RMB8 million. In addition, as of December 31, 2018, we were notified by local government authorities that we may have to demolish seven additional leased hotels due to local zoning requirements. Our franchise agreements typically provide that if the manachised or franchised hotels are demolished, the franchise agreements will terminate. In 2018, we demolished 22 manachised hotels due to local government zoning requirements. Similar demolitions, termination of franchise agreements or interruptions of our hotel operations due to zoning or other local regulations could occur in the future. Any such further demolition and relocation could cause us to lose primary locations for our hotels and we may not be able to achieve comparable operation results following the relocations. While we may be reimbursed for such demolition and relocation, we cannot assure you that the reimbursement, as determined by the relevant government authorities, will be sufficient to cover our direct and indirect losses. Accordingly, our business, results of operations and financial condition could be adversely affected.

Governmental control of currency conversion may limit our ability to pay dividends in foreign currencies to our shareholders and therefore adversely affect the value of your investment.

We are a company incorporated in the Cayman Islands. Our ability to pay dividends depends upon, among other things, our PRC subsidiaries ability to obtain and remit sufficient foreign currency. Our PRC subsidiaries must present certain documents to SAFE, its authorized branch, or the designated foreign exchange bank, for approval before they can obtain and remit foreign currencies out of the PRC, including evidence that the relevant PRC taxes have been paid. If our PRC subsidiaries, for any reason, fail to satisfy any of the PRC legal requirements for remitting foreign currency, our ability to pay dividends would be adversely affected.

The PRC government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China. See Item 4. Information on the Company B. Business Overview Regulation Regulations on Foreign Currency Exchange for discussions of the principal regulations and rules governing foreign currency exchange in China. We receive substantially all of our revenues in RMB. For most capital account items, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs, which would adversely affect the value of your investment.

Fluctuation in the value of the Renminbi may have a material adverse effect on your investment.

The value of the Renminbi against the U.S. dollar, Euro and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies.

Edgar Filing: Huazhu Group Ltd - Form 20-F

Our revenues and costs are mostly denominated in the Renminbi, and a significant portion of our financial assets are also denominated in the Renminbi. We rely substantially on dividends paid to us by our operating subsidiaries in China. Any significant depreciation of the Renminbi against the U.S. dollar may have a material adverse effect on our revenues, and the value of, and any dividends payable on, our ADSs and ordinary shares. If we decide to convert our Renminbi into U.S. dollars for the purpose of making payments for dividends on our ordinary shares or for other business purposes, depreciation of the Renminbi against the U.S. dollar would reduce the U.S. dollar amount available to us. On the other hand, to the extent that we need to convert U.S. dollars into Renminbi for our operations, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we receive from the conversion. See Item 11. Quantitative and Qualitative Disclosures about Market Risk Foreign Exchange Risk for discussions of our exposure to foreign currency risks. In summary, fluctuation in the value of the Renminbi in either direction could have a material adverse effect on the value of our company and the value of your investment.

Table of Contents

PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders to personal liability and limit our ability to inject capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to distribute profits to us, or otherwise adversely affect us.

On July 4, 2014, SAFE issued the *Notice on Issues Relating to the Administration of Foreign Exchange for Overseas Investment and Financing and Reverse Investment by Domestic Residents via Special Purpose Vehicles*, or Circular 37, which replaced the *Notice on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles* issued by SAFE in October 2005, or Circular 75. Pursuant to Circular 37, any PRC residents, including both PRC institutions and individual residents, are required to register with the local SAFE branch before making contribution to a company set up or controlled by the PRC residents outside of the PRC for the purpose of overseas investment or financing with their legally owned domestic or offshore assets or interests, referred to in this circular as a special purpose vehicle. In addition, such PRC residents or entities must update their SAFE registrations when the offshore special purpose vehicle undergoes material events relating to any change of basic information (including change of such PRC citizens or residents, name and operation term), increases or decreases in investment amount, transfers or exchanges of shares, or mergers or divisions. In February 2015, SAFE promulgated the *Notice on Further Simplifying and Improving the Administration of the Foreign Exchange Concerning Direct Investment*, which took effect on June 1, 2015. This notice has amended SAFE Circular 37, requiring PRC residents or entities to register with qualified banks rather than SAFE or its local branch in connection with their establishment or control of an offshore entity established for the purpose of overseas investment or financing. See Item 4. Information on the Company B. Business Overview Regulation Regulations on Offshore Financing for discussions of the registration requirements and the relevant penalties.

We attempt to comply, and attempt to ensure that our shareholders and beneficial owners of our shares who are subject to these rules comply, with the relevant requirements. We cannot provide any assurance that our shareholders and beneficial owners of our shares who are PRC residents have complied or will comply with the requirements imposed by Circular 37 or other related rules. Any failure by any of our shareholders and beneficial owners of our shares who are PRC residents to comply with relevant requirements under this regulation could subject such shareholders, beneficial owners and us to fines or sanctions imposed by the PRC government, including limitations on our relevant subsidiary's ability to pay dividends or make distributions to us and our ability to increase our investment in China, or other penalties that may adversely affect our operations.

We rely principally on dividends and other distributions on equity paid by our subsidiaries to fund any cash and financing requirements we may have, and any limitation on the ability of our subsidiaries to make payments to us could have a material adverse effect on our ability to conduct our business.

We are a holding company, and we rely principally on dividends from our subsidiaries in China for our cash requirements, including any debt we may incur. Current PRC regulations permit our subsidiaries to pay dividends to us only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, each of our subsidiaries in China is required to set aside a certain amount of its after-tax profits each year, if any, to fund certain statutory reserves. These reserves are not distributable as cash dividends. As of December 31, 2018, a total of RMB502 million (US\$73 million) was not distributable in the form of dividends to us due to these PRC regulations. Furthermore, if our subsidiaries in China incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us. The inability

of our subsidiaries to distribute dividends or other payments to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends, or otherwise fund and conduct our business.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from using the proceeds from offerings of the ADSs, ordinary shares or other securities to make loans or additional capital contributions to our PRC operating subsidiaries.

As an offshore holding company, our ability to make loans or additional capital contributions to our PRC operating subsidiaries is subject to PRC regulations and approvals. These regulations and approvals may delay or prevent us from using the proceeds we received in the past or will receive in the future from the offerings of ADSs, ordinary shares or other securities to make loans or additional capital contributions to our PRC operating subsidiaries, and impair our ability to fund and expand our business which may adversely affect our business, financial condition and result of operations. For example, SAFE promulgated the Circular of the State Administration of Foreign Exchange on Reforming and Regulating Policies on the Control over Foreign Exchange Settlement of Capital Accounts, or Circular 16, on June 9, 2016. Under Circular 16, registered capital of a foreign-invested company settled in RMB converted from foreign currencies shall be subject to certain limitations prescribed under Circular 16. In addition, foreign-invested companies may not change how they use such capital without SAFE's approval, and may not in any case use such capital to repay RMB loans if they have not used the proceeds of such loans.

Table of Contents

Furthermore, any offshore funds that we use to finance our PRC entities, including the net proceeds from the offering of the ADSs, ordinary shares or other securities, are subject to the foreign investment regulations and foreign exchange regulations in the PRC. We may make loans to our PRC entities, but they are subject to approval by or registration with relevant governmental authorities in the PRC. Furthermore, the application of the proceeds under the ADSs, ordinary shares or other securities is subject to the foreign exchange regulations in the PRC. We may also decide to finance our entities by means of capital contributions. According to the relevant PRC regulations on foreign-invested enterprises in China, depending on the total amount of investment, capital contributions to our PRC operating subsidiaries is no longer subject to the approval of the PRC Ministry of Commerce or its local branches. Instead, we are required to file and submit required information and documents online within 30 days of such event. However, we cannot assure you that the regulations will always remain favorable to us. If the regulations are revised in the future or we fail to complete such registration or obtain such approvals on time, our ability to use the proceeds of the ADSs, ordinary shares or other securities and to capitalize our operations in PRC may be negatively affected, which could adversely affect our liquidity and our ability to fund and expand our business.

We may be subject to fines and legal sanctions imposed by SAFE or other Chinese government authorities and our ability to further grant shares or share options to, and to adopt additional share incentive plans for, our directors and employees may be restricted if we or the participants of our share incentive plans fail to comply with PRC regulations relating to employee shares or share options granted by offshore special purpose companies or offshore listed companies to PRC participants.

In February 2012, the SAFE issued the *Notice on Relevant Issues Concerning Foreign Exchange Control on Domestic Individuals Participating in the Stock Incentive Plan of An Overseas Listed Company*, or Circular 7, which requires PRC individual participants of stock incentive plans to register with the SAFE and to comply with a series of other requirements. See Item 4. Information on the Company B. Business Overview Regulation Regulations on Foreign Currency Exchange. We are an offshore listed company and as a result we and the participants of our share incentive plans who are PRC citizens or foreigners having lived within the territory of the PRC successively for at least one year, or, collectively, the PRC participants, are subject to Circular 7. While we completed the foreign exchange registration procedures and complied with other requirements according to Circular 7 in June 2012, we cannot provide any assurance that we or the PRC individual participants of our share incentive plans have complied or will comply with the requirements imposed by Circular 7. If we or the PRC participants of our share incentive plans fail to comply with Circular 7, we or the PRC participants of our share incentive plans may be subject to fines or other legal sanctions imposed by SAFE or other PRC government authorities and our ability to further grant shares or share options under our share incentive plans to, and to adopt additional share incentive plans for, our directors and employees may be restricted. Such events could adversely affect our business operations.

It is unclear whether we will be considered as a PRC resident enterprise under the Enterprise Income Tax Law of the PRC, and depending on the determination of our PRC resident enterprise status, if we are not treated as a PRC resident enterprise, dividends paid to us by our PRC subsidiaries will be subject to PRC withholding tax; if we are treated as a PRC resident enterprise, we may be subject to 25% PRC income tax on our worldwide income, and holders of our ADSs or ordinary shares that are non-PRC resident investors may be subject to PRC withholding tax on dividends on and gains realized on their transfer of our ADSs or ordinary shares.

On March 16, 2007, the PRC National People's Congress passed the *Enterprise Income Tax Law*, and the PRC State Council subsequently issued the *Implementation Regulations of the Enterprise Income Tax Law* (the *Implementing Regulations*). The Enterprise Income Tax Law (amended in 2018) and its Implementation Regulations, or the *EIT Law*, provides that enterprises established outside of China whose *de facto* management bodies are located in China are considered resident enterprises and are therefore subject to PRC enterprise income tax at the rate of 25% with respect to their income sourced from both within and outside of China. The Implementing Regulations defines the term *de facto* management body as a management body that exercises substantial and overall control and management over the production and operations, personnel, accounting and properties of an enterprise.

Table of Contents

On April 22, 2009, the State Taxation Administration, or the STA (previously known as State Administration of Taxation, or the SAT) issued the Notice Regarding the Determination of Chinese-Controlled Offshore Incorporated Enterprises as PRC Tax Resident Enterprises on the Basis of De Facto Management Bodies, or Circular 82. Circular 82 provides certain specific criteria for determining whether the de facto management body of a Chinese-controlled offshore-incorporated enterprise is located in China. In addition, the SAT issued Public Announcement [2011] No. 45 in 2011 and Public Announcement [2014] No.9 in 2014, providing clarification for resident status determination and competent tax authorities. However, the above-mentioned tax circulars apply only to offshore enterprises controlled by PRC enterprises, not those invested in or controlled by PRC individuals, like our company. Currently, there are no further detailed rules or precedents applicable to us regarding the procedures and specific criteria for determining de facto management body for a company like us. It is still unclear if the PRC tax authorities would determine that we should be classified as a PRC resident enterprise.

Although we have not been notified that we are treated as a PRC resident enterprise, we cannot assure you that we will not be treated as a resident enterprise under the EIT Law, any aforesaid circulars or any amended regulations in the future. If we are treated as a PRC resident enterprise for PRC enterprise income tax purposes, among other things, we would be subject to the PRC enterprise income tax at the rate of 25% on our worldwide taxable income. Furthermore, if we are treated as a PRC resident enterprise, payments of dividend by us may be regarded as derived from sources within the PRC and therefore we may be obligated to withhold PRC income tax at 10% on payments of dividend on the ADSs or shares to non-PRC resident enterprise investors. In the case of non-PRC resident individual investors, the tax may be withheld at a rate of 20%.

In addition, if we are treated as a PRC resident enterprise, any gain realized on the transfer of the ADSs and/or shares by non-PRC resident investors may be regarded as derived from sources within the PRC and accordingly may be subject to a 10% PRC income tax in the case of non-PRC resident enterprises or 20% in the case of non-PRC resident individuals. The PRC tax on dividends and/or gains may be reduced or exempted under applicable tax treaties between the PRC and the ADS holder's home country. See Item 10. Additional Information E. Taxation PRC Taxation.

The audit report included in this annual report was prepared by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, you are deprived of the benefits of such inspection.

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the SEC, as auditors of companies that are traded publicly in the United States and a firm registered with the United States Public Company Accounting Oversight Board, or the PCAOB, is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws and professional standards of the United States. Because our auditors are located in the PRC, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, our auditors are not currently inspected by the PCAOB.

Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. The lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures and quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. As a result, investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

Table of Contents

If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, with respect to requests for the production of documents, we could be unable to timely file future financial statements in compliance with the requirements of the Securities Exchange Act of 1934.

Starting in 2011, the Chinese affiliates of the big four accounting firms, (including our independent registered public accounting firm) were affected by a conflict between US law and Chinese law. Specifically, for certain US listed companies operating and audited in mainland China, the SEC and the PCAOB sought to obtain from the Chinese firms access to their audit work papers and related documents. The firms were, however, advised and directed that under Chinese law they could not respond directly to the US regulators on those requests, and that requests by foreign regulators for access to such papers in China had to be channeled through the CSRC.

In late 2012 this impasse led the SEC to commence administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the Chinese accounting firms, (including our independent registered public accounting firm). A first instance trial of the proceedings in July 2013 in the SEC's internal administrative court resulted in an adverse judgment against the firms. The administrative law judge proposed penalties on the firms including a temporary suspension of their right to practice before the SEC, although that proposed penalty did not take effect pending review by the Commissioners of the SEC. On February 6, 2015, before a review by the Commissioner had taken place, the firms reached a settlement with the SEC. Under the settlement, the SEC accepts that future requests by the SEC for the production of documents will normally be made to the CSRC. The firms will receive matching Section 106 requests, and are required to abide by a detailed set of procedures with respect to such requests, which in substance require them to facilitate production via the CSRC. If they fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. Remedies for any future noncompliance could include, as appropriate, an automatic six-month bar on a single firm's performance of certain audit work, commencement of a new proceeding against a firm, or in extreme cases the resumption of the current proceeding against all four firms.

In the event that the SEC restarts the administrative proceedings, depending upon the final outcome, listed companies in the United States with major PRC operations may find it difficult or impossible to retain auditors in respect of their operations in the PRC, which could result in financial statements being determined to not be in compliance with the requirements of the Exchange Act, including possible delisting. Moreover, any negative news about any such future proceedings against these audit firms may cause investor uncertainty regarding China-based, United States-listed companies and the market price of our ADSs may be adversely affected.

If our independent registered public accounting firm were denied, even temporarily, the ability to practice before the SEC and we were unable to timely find another registered public accounting firm to audit and issue an opinion on our financial statements, our financial statements could be determined not to be in compliance with the requirements of the Securities Exchange Act of 1934, as amended. Such a determination could ultimately lead to the delisting of our ordinary shares from the Nasdaq Global Market or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

Risks Related to Our ADSs and Our Trading Market

The market price for our ADSs has been and may continue to be volatile.

Edgar Filing: Huazhu Group Ltd - Form 20-F

The market price for our ADSs has been volatile and has ranged from a low of US\$24.9 to a high of US\$49.6 on the NASDAQ Global Select Market in 2018. The market price is subject to wide fluctuations in response to various factors, including the following:

- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- conditions in the travel and lodging industries;
- changes in the economic performance or market valuations of other lodging companies;
- announcements by us or our competitors of new products, acquisitions, strategic partnerships, joint ventures or capital commitments;
- addition or departure of key personnel;

Table of Contents

- fluctuations of exchange rates between the RMB and U.S. dollar or other foreign currencies;
- potential litigation or administrative investigations;
- release of lock-up or other transfer restrictions on our outstanding ADSs or ordinary shares or sales of additional ADSs; and
- general economic or political conditions in China.

In addition, the market prices for companies with operations in China in particular have experienced volatility that might have been unrelated to the operating performance of such companies. The securities of some China-based companies that have listed their securities in the United States have experienced significant volatility, including, in some cases, substantial declines in the market prices of their securities. The performance of the securities of these China-based companies after their offerings may affect the attitudes of investors toward Chinese companies listed in the United States, which consequently may impact the performance of our ADSs, regardless of our actual operating performance. In addition, any negative news or perceptions about inadequate corporate governance practices or fraudulent accounting, corporate structure or other matters of other China-based companies may also negatively affect the attitudes of investors towards China-based companies in general, including us, regardless of whether we have engaged in any inappropriate activities.

The global financial crisis and the ensuing economic recessions in many countries have contributed and may continue to contribute to extreme volatility in the global stock markets, such as the large declines in share prices in the United States, China and other jurisdictions at various times since 2008. These broad market and industry fluctuations may adversely affect the price of our ADSs, regardless of our operating performance.

We may need additional capital, and the sale of additional ADSs or other equity securities could result in additional dilution to our shareholders and the incurrence of additional indebtedness could increase our debt service obligations.

We believe that our current cash and cash equivalents, anticipated cash flow from operations, and funds available from borrowings under our bank facilities (including the undrawn bank facilities currently available to us and bank facilities we plan to obtain in 2019) will be sufficient to meet our anticipated working capital cash needs for at least the next 12 months. We may, however, require additional cash resources due to changed business conditions, strategic acquisitions or other future developments, including expansion through leased and owned hotels and any investments or acquisitions we may decide to pursue. If these resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity and equity-linked securities could result in additional dilution to our shareholders. The sale of substantial amounts of our ADSs could dilute the interests of our shareholders and ADS holders and adversely impact the market price of our ADSs. As of December 31, 2018, we had approximately 162.6 million ordinary shares outstanding held as ADSs, options to purchase approximately 1.1 million ordinary shares (of which approximately 1.1 million were exercisable as of that date) and approximately 12.1 million nonvested restricted stocks outstanding. The conversion of some or all of the convertible senior notes will dilute the ownership interests of

existing shareholders and holders of the ADSs. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

Future sales or issuances, or perceived future sales or issuances, of substantial amounts of our ordinary shares or ADSs could adversely affect the price of our ADSs.

If our existing shareholders sell, or are perceived as intending to sell, substantial amounts of our ordinary shares or ADSs, including those issued upon the exercise of our outstanding stock options, the market price of our ADSs could fall. Such sales, or perceived potential sales, by our existing shareholders might make it more difficult for us to issue new equity or equity-related securities in the future at a time and place we deem appropriate. Shares held by our existing shareholders may be sold in the public market in the future subject to the restrictions contained in Rule 144 and Rule 701 under the Securities Act and the applicable lock-up agreements. If any existing shareholder or shareholders sell a substantial amount of ordinary shares after the expiration of the lock-up period, the prevailing market price for our ADSs could be adversely affected.

Table of Contents

In addition, certain of our shareholders or their transferees and assignees will have the right to cause us to register the sale of their shares under the Securities Act upon the occurrence of certain circumstances. Registration of these shares under the Securities Act would result in these shares becoming freely tradable without restriction under the Securities Act immediately upon the effectiveness of the registration. Sales of these registered shares in the public market could cause the price of our ADSs to decline.

As our founder and co-founders collectively hold a controlling interest in us, they have significant influence over our management and their interests may not be aligned with our interests or the interests of our other shareholders.

As of March 31, 2019, our founder, Mr. Qi Ji, who is also our executive chairman, and our co-founders, Ms. Tong Tong Zhao and Mr. John Jiong Wu, in total beneficially own approximately 36.8% of our outstanding ordinary shares on an as-converted basis. See Item 7. Major Shareholders. The interests of these shareholders may conflict with the interests of our other shareholders. Our founder and co-founders have significant influence over us, including on matters relating to mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of us, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of us or of our assets and might reduce the price of our ADSs. These actions may be taken even if they are opposed by our other shareholders, including holders of our ADSs.

ADS holders may not have the same voting rights as the holders of our ordinary shares and generally have fewer rights than our ordinary shareholders, and must act through the depositary to exercise those rights.

Holders of ADSs do not have the same rights as our ordinary shareholders and may only exercise voting and other shareholder rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Except as described in the deposit agreement, holders of our ADSs may not be able to exercise voting rights attaching to the shares evidenced by our ADSs on an individual basis. Holders of our ADSs appoint the depositary or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. ADS holders may not receive voting materials in time to instruct the depositary to vote, and it is possible that they may not have the opportunity to exercise a right to vote and/or may lack recourse if the ADSs are not voted as you requested.

ADS holders may not be able to participate in rights offerings and may experience dilution of his, her or its holdings as a result.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement for the ADSs, the depositary will not offer those rights to ADS holders unless both the rights and the underlying securities to be distributed to ADS holders are either registered under the Securities Act, or exempt from registration under the Securities Act with respect to all holders of ADSs. We are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to cause such a registration statement to be declared effective. In addition, we may not be able to take advantage of any exemptions from registration under the Securities Act. Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution in their holdings as a result.

ADS holders may be subject to limitations on transfer of their ADSs.

Our ADSs are transferable on the books of the depositary. However, the depositary may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties. In addition, the depositary may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary deem it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

Table of Contents

As a foreign private issuer, we are permitted to, and we will, rely on exemptions from certain NASDAQ corporate governance standards applicable to U.S. issuers, including the requirement regarding the implementation of a nominations committee. This may afford less protection to holders of our ordinary shares and ADSs.

The NASDAQ Marketplace Rules in general require listed companies to have, among other things, a nominations committee consisting solely of independent directors. As a foreign private issuer, we are permitted to, and we will, follow home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules, including, among others, the implementation of a nominations committee. The corporate governance practice in our home country, the Cayman Islands, does not require the implementation of a nominations committee. We currently intend to rely upon the relevant home country exemption in lieu of the nominations committee. As a result, the level of independent oversight over management of our company may afford less protection to holders of our ordinary shares and ADSs.

Our articles of association contain anti-takeover provisions that could have a material adverse effect on the rights of holders of our ordinary shares and ADSs.

Our amended and restated articles of association contain provisions that have potential to limit the ability of others to acquire control of our company or cause us to enter into change-of-control transactions. These provisions could have the effect of depriving our shareholders of opportunities to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transaction.

For example, our board of directors has the authority, without further action by our shareholders, to issue preferred shares in one or more classes or series and to fix their designations, powers, preferences, and relative participating, optional or other rights and the qualifications, limitations or restrictions, including, without limitation, dividend rights, conversion rights, voting rights, terms of redemption privileges and liquidation preferences, any or all of which may be greater than the rights associated with our ordinary shares, in the form of ADSs or otherwise. In the event these preferred shares have better voting rights than our ordinary shares, in the form of ADSs or otherwise, they could be issued quickly with terms calculated to delay or prevent a change in control of our company or make removal of management more difficult. If our board of directors decides to issue preferred shares, the price of our ADSs may decline and the voting and other rights of the holders of our ordinary shares and ADSs may be materially and adversely affected.

The provisions of our articles of association may encourage potential acquirers to negotiate with us and allow our board of directors the opportunity to consider alternative proposals in the interest of maximizing shareholder value. However, these provisions may also discourage acquisition proposals or delay or prevent a change in control that could be beneficial to holders of our ordinary shares and ADSs.

You may face difficulties in protecting your interests, and your ability to protect your rights through the U.S. federal courts may be limited, because we are incorporated under Cayman Islands law, conduct substantially all of our operations in China and the majority of our officers reside outside the United States.

We are incorporated in the Cayman Islands, and conduct substantially all of our operations in China through our subsidiaries in China. Most of our officers reside outside the United States and some or all of the assets of those persons are located outside of the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the Cayman Islands or in China in the event that you believe that your rights have been infringed under the securities laws or otherwise. Even if you are successful in bringing an action of

this kind outside the Cayman Islands or China, the laws of the Cayman Islands and of China may render you unable to effect service of process upon, or to enforce a judgment against our assets or the assets of our directors and officers. There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize and enforce a judgment of a foreign court of competent jurisdiction for a liquidated sum, other than a sum payable in respect of taxes, fines, penalties or similar fiscal or revenue obligations, and which was neither obtained in a manner nor is of a kind enforcement of which is contrary to natural justice or the public policy of the Cayman Islands and which is not inconsistent with a Cayman Islands judgment in respect of the same matters and which is not impeachable on grounds of fraud, without retrial on the merits under the common law by an action commenced on the judgment in the Grand Court of the Cayman Islands. A judgment of a court of another jurisdiction may be reciprocally recognized or enforced if the jurisdiction has a treaty with China or if judgments of the PRC courts have been recognized before in that jurisdiction, subject to the satisfaction of other requirements. However, China does not have treaties providing for the reciprocal enforcement of judgments of courts with Japan, the United Kingdom, the United States and most other Western countries.

Table of Contents

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (2018 Revision) and the common law of the Cayman Islands. The rights of shareholders to take legal action against our directors and us, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

As a result of all of the above, our public shareholders may have more difficulty in protecting their interests through actions against our management, directors or major shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States.

We may be classified as a passive foreign investment company, which could result in adverse United States federal income tax consequences for U.S. Holders of our ADSs or ordinary shares.

Based on our audited financial statements and relevant market and shareholder data, we believe that we should not be treated as a passive foreign investment company (a PFIC) for U.S. federal income tax purposes with respect to the 2017 and 2018 taxable years. In addition, based on our audited financial statements and our current expectations regarding the value and nature of our assets, the sources and nature of our income, and relevant market and shareholder data, we do not anticipate becoming a PFIC for our 2019 taxable year. The application of the PFIC rules is subject to ambiguity in several respects and, in addition, we must make annual separate determinations each year as to whether we are a PFIC (after the close of each taxable year). The determination of whether we are or will become a PFIC will depend in part upon the value of our goodwill and other unbooked intangibles (which will depend upon the market price of our ADSs from time to time, which may be volatile). Among other matters, if our market capitalization declines, we may be or become a PFIC for the current or future taxable years. It is also possible that the Internal Revenue Service may challenge our classification or valuation of our goodwill and other unbooked intangibles, which may result in our company being or becoming a PFIC for the current or one or more future taxable years. Accordingly, we cannot assure you of our PFIC status for our current taxable year ending December 31, 2019 or for any future taxable year. If we were treated as a PFIC for any taxable year during which a U.S. Holder held an ADS or an ordinary share, certain adverse United States federal income tax consequences could apply to the U.S. Holder (as defined herein). For a more detailed discussion of United States federal income tax consequences to U.S. Holders, see Item 10. Additional Information E. Taxation U.S. Federal Income Taxation Passive Foreign Investment Company.

ITEM 4. INFORMATION ON THE COMPANY

4.A. History and Development of the Company

Powerhill was incorporated in accordance with the laws of the British Virgin Islands in December 2003, and commenced operation with midscale limited service hotels and commercial property development and management in 2005. Limited service hotels do not contain restaurants and all amenities are provided by the staff at the front desk or housekeeping. Powerhill conducted its operations through three

wholly-owned subsidiaries in the PRC, namely Shanghai HanTing Hotel Management Group, Ltd., or Shanghai HanTing, HanTing Xingkong (Shanghai) Hotel Management Co., Ltd., or HanTing Xingkong, and Lishan Property (Suzhou) Co., Ltd., or Suzhou Property. In August 2006, Suzhou Property transferred its equity interests in three leased hotels to Shanghai HanTing in exchange for Shanghai HanTing's equity interest in Shanghai Shuyu Co., Ltd., which was primarily engaged in the business of sub-leasing and managing real estate properties in technology parks.

Table of Contents

Our company was incorporated in the Cayman Islands in January 2007 under the name of China Lodging Group, Limited, or China Lodging. In February 2007, Powerhill transferred all of its ownership interests in HanTing Xingkong and Shanghai HanTing to China Lodging in exchange for preferred shares of China Lodging. After such exchange, each of HanTing Xingkong and Shanghai HanTing became a wholly-owned subsidiary of China Lodging. In addition, in February 2007, Powerhill and its subsidiary, Suzhou Property, were spun off in the form of a dividend distribution to the shareholders.

In 2007, China Lodging began our current business of operating and managing a multi-brand hotel group. In 2007, we first launched our economy hotel product, *HanTing Express Hotel*, which was subsequently rebranded as *HanTing Hotel*, targeting knowledge workers and value- and quality-conscious travelers. In the same year, we introduced our midscale limited service hotel product, *HanTing Hotel*, which was subsequently rebranded first as *HanTing Seasons Hotel* and then as *Ji Hotel*. In 2008, we launched our budget hotel product, *HanTing Hi Inn*, which was subsequently rebranded as *Hi Inn*. In April 2007, China Lodging acquired Yiju (Shanghai) Hotel Management Co., Ltd. from Crystal Water Investment Holdings Limited, a British Virgin Islands company wholly owned by Mr. John Jiong Wu, a co-founder of our company. In January 2008, China Lodging incorporated HanTing (Tianjin) Investment Consulting Co., Ltd. in China and in October 2008, established China Lodging Holdings (HK) Limited, or China Lodging HK, in Hong Kong, under which HanTing Technology (Suzhou) Co., Ltd. was subsequently established in China in December 2008.

In March 2010, we completed our initial public offering. We issued and sold 10,350,000 ADSs, representing 41,400,000 of our ordinary shares at a public offering price of US\$12.25 per ADS. Our ADSs have been listed on the NASDAQ Global Select Market since March 26, 2010. Our ordinary shares are not listed or publicly traded on any trading markets.

In May 2012, we acquired a 51% equity interest in Starway HK, a midscale hotel chain and increased our hotel brands to four brands. In December 2013, we acquired the remaining 49% equity interest of Starway HK from C-Travel. In addition, we launched *Manxin Hotels & Resorts* in October 2013, which was subsequently rebranded as *Manxin Hotel*, *Joya Hotel*, a new hotel brand targeting the upscale market, in December 2013, and *Elan Hotel*, a new economy hotel brand, in September 2014. In November 2012, we changed the Chinese trade name of our company from HanTing Hotel Group to HuaZhu Hotel Group .

In late 2014, we established Chengjia Hotel Management Co., Ltd. (Chengjia) in Shanghai, which started operation in the second quarter of 2015. Since then, it has maintained a professional apartment service management team and provided apartment rental service that covers leases for a term from one month up to twelve months. In 2016, we sold Chengjia to Cjia, our equity investee. After the completion of restructuring of Cjia in 2018, all equity interests we held in Cjia were converted into the equity interests of China Cjia Group Limited. As of December 31, 2018, we held approximately 20% equity interest in China Cjia Group Limited.

In December 2014, we entered into agreements with Accor to join forces in the Pan-China region to develop Accor brand hotels and to form an extensive and long-term alliance with Accor. The transactions with Accor were completed in the first quarter of 2016. Pursuant to the amended and restated master purchase agreement with Accor, we acquired from Accor (i) all of the issued and outstanding shares of certain wholly-owned subsidiaries of Accor engaged in the business of owning, leasing, franchising, operating and managing hotels under Accor brands in the midscale and economy market in the PRC, Taiwan and Mongolia, and (ii) approximately 28% of the issued and outstanding shares of

Edgar Filing: Huazhu Group Ltd - Form 20-F

AAPC LUB, a Hong Kong subsidiary of Accor that engages in the business of owning, leasing, franchising, operating and managing hotels under Accor brands (x) in the luxury and upscale market in Hong Kong, Macau, Taiwan, the PRC and Mongolia, and (y) in the midscale and economy market in Hong Kong and Macau and, pursuant to certain arrangements for specified brands, the PRC, Mongolia and Taiwan. Pursuant to the amended and restated securities purchase agreement, we issued 24,895,543 ordinary shares to Accor, which represented 9.0% of our ordinary shares outstanding after issuance, and granted to Accor a right to nominate one director to our board of directors.

In connection with the amended and restated master purchase agreement and the amended and restated securities purchase agreement, we and Accor also entered into a number of additional agreements, including, among others: (i) a master brand agreement and brand franchise agreements, pursuant to which Accor granted to us exclusive franchise rights in respect of *Mercurie*, *Ibis* and *Ibis Styles* in the PRC, Taiwan and Mongolia, and non-exclusive franchise rights in respect of *Grand Mercure* and *Novotel* in the PRC, Taiwan and Mongolia (AAPC LUB being the only other entity with non-exclusive franchise rights in respect of *Grand Mercure* and *Novotel* in the same territories); all hotels under these brands will continue to be managed under Accor's brand standards and have all benefits of Accor's international distribution and loyalty platforms, and will also participate in our loyalty and distribution platforms and benefit from our on-the-ground support; (ii) a shareholders agreement in relation to the governance of AAPC LUB and our rights and obligations as shareholder of the company; (iii) a registration rights agreement in favor of Accor in respect of our ordinary shares that it acquired under the amended and restated securities purchase agreement; (iv) an amended and restated non-competition agreement that sets out certain business restrictions on us and Accor, and imposes certain lockup and standstill restrictions on Accor with respect to our equity securities; and (v) a deed of voting and ROFR, pursuant to which, among other things, (x) Accor has a right of first refusal in respect of transfers of our securities by Qi Ji or his affiliates, and (y) we and Qi Ji agreed to procure the appointment of a nominee of Accor to our board of directors (for so long as Accor and its affiliates own our ordinary shares or ADSs representing at least 8% of a pro forma number of our outstanding share capital, and subject to certain termination events described in the deed of voting and ROFR); and our articles of association were also amended and restated effective as of January 25, 2016 to give effect to Accor's rights as described in the foregoing.

Table of Contents

In May 2017, we completed the acquisition of all of the equity interests in Crystal Orange, which holds hotels under the brands *Crystal Orange Hotel*, *Orange Hotel Select* and *Orange Hotel*.

In November 2017, we issued US\$475.0 million of convertible senior notes (the Notes). The Notes will mature on November 1, 2022 and bear interest at a rate of 0.375% per annum, payable in arrears semi-annually on May 1 and November 1, beginning May 1, 2018. The Notes can be converted into our ADSs at an initial conversion rate of 5.4869, before the ADS split, subject to change, of our ADSs per US\$1,000 principal amount of the Notes (equivalent to an initial conversion price of US\$182.25 per ADS).

In April 2018, we effected a four-for-one ADS split, pursuant to which each of our ADS represents one ordinary share.

On June 1, 2018, we changed our name to Huazhu Group Limited, or Huazhu.

In August 2018, we completed the acquisition in steps of 83% equity interest of Blossom Hill, which was engaged in the business of operating and managing hotels under Blossom Hill brand in the upscale market in the PRC. As of December 31, 2018, we owned an aggregate of 94% equity interest in Blossom Hill after acquiring part of the remaining equity interest from the noncontrolling interest holders. As of December 31, 2018, Blossom Hill Hotels & Resorts had 18 hotels in operation located near typical scenic spots.

Our principal executive offices are located at No. 2266 Hongqiao Road, Changning District, Shanghai 200336, People's Republic of China. Our telephone number at this address is +86 (21) 6195-2011. Our registered office in the Cayman Islands is located at the offices of Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KY1-1111, Cayman Islands. Our agent for service of process in the United States is CT Corporation System, located at 111 Eighth Avenue, 13th Floor, New York, New York 10011.

Investors should contact us for any inquiries through the address and telephone number of our principal executive offices. Our website is <http://www.huazhu.com>. The information contained on our website is not a part of this annual report.

SEC maintains an internet site (<http://www.sec.gov>), which contains reports, proxy and information statements, and other information regarding us that file electronically with the SEC.

4.B. Business Overview

We are a leading and fast-growing multi-brand hotel group in China. We operate under leased and owned, managed and franchised models. Under the lease and ownership model, we directly operate hotels located primarily on leased

or owned properties. Under the manachise model, we manage manachised hotels through the on-site hotel managers we appoint and collect fees from franchisees. Under the franchise model, we provide training, reservation and support services to the franchised hotels and collect fees from franchisees but do not appoint on-site hotel managers. We apply a consistent standard and platform across all of our hotels. As of December 31, 2018, we had 699 leased and owned hotels, 3,309 manachised hotels and 222 franchised hotels in operation, 42 leased and owned hotels and 1,063 manachised and franchised hotels under development.

Table of Contents

As of the date of this annual report, we own 12 hotel brands that are designed to target distinct segments of customers:

- *Hi Inn*, our budget hotel product which targets practical and price-conscious travelers, originally marketed under the name of *HanTing Hi Inn*;
- *HanTing Hotel*, our economy hotel product which targets knowledge workers and value- and quality-conscious travelers, originally marketed under the name of HanTing Express Hotel;
- *Elan Hotel*, our economy hotel product which targets business travelers, young customers and urban tourists. *Elan Hotel* is committed to provide a unique business and travel life experience for its guests;
- *Orange Hotel*, our economy brand, features three-star standard facilities at affordable prices;
- *HanTing Premium*, our entry level midscale hotel brand targeting middle class leisure travelers and midscale corporate events;
- *Starway Hotel*, our midscale limited service hotel product with variety in design and consistency in quality which targets middle class travelers who seek a spacious room, reasonable price and guaranteed quality;
- *Ji Hotel*, our standardized midscale limited service hotel product which targets mature and experienced travelers who seek a quality experience in hotel stays, previously marketed first under the name of *HanTing Hotel* and then HanTing Seasons Hotel;
- *Orange Hotel Select*, our midscale hotel brand, is the mini version of our *Crystal Orange Hotel*;
- *Manxin Hotel*, our mid-to-upscale hospitality brand including city hotels and resorts. *Manxin Hotel* targets business travelers, leisure travelers, families and corporate events;

- *Crystal Orange Hotel*, our mid-to-upscale hotel brand, features boutique design hotels equipped with advanced, five-star standard facilities;
- *Joya Hotel*, our upscale brand concept targeting affluent travelers and corporate events. Joya hotels are typically located in central business districts; and
- *Blossom Hill Hotels & Resorts*, our upscale lifestyle and resort brand targeting affluent travelers. Most of Blossom Hill's hotels are located near typical scenic spots.

In addition to the 12 hotel brands owned by us, we have also entered into brand franchise agreements with Accor and enjoyed exclusive franchise rights in respect of *Mercure*, *Ibis* and *Ibis Styles* in the PRC, Taiwan and Mongolia and non-exclusive franchise rights in respect of *Grand Mercure* and *Novotel* in the PRC, Taiwan and Mongolia:

- *Ibis*, an economy hotel brand that is recognized across the world for its quality, reliability and commitment to the environment.
- *Ibis Styles*, a midscale brand that offers comfortable, designer hotels at an all-inclusive rate;
- *Mercure*, a midscale hotel brand that targets business and leisure travelers around the world;
- *Novotel*, a mid-to-upscale brand that provides a multi-service offer for both business and leisure guests; and
- *Grand Mercure*, a brand that offers a upscale network of hotels and apartments that combine local culture with world-class services;

As a result of our customer-oriented approach, we have developed strong brand recognition and a loyal customer base. In 2018, approximately 76% of our room nights were sold to individual and corporate members of HUAZHU Rewards, our loyalty program.

Table of Contents

Our operations commenced with midscale limited service hotels and commercial property development and management in 2005. We began our current business of operating and managing a multi-brand hotel group in 2007. Our net revenues grew from RMB6,573 million in 2016 to RMB8,229 million in 2017, and further to RMB10,063 million (US\$1,464 million) in 2018. We had net income attributable to our company of RMB782 million, RMB1,228 million and RMB716 million (US\$104 million) in 2016, 2017 and 2018, respectively. We had net cash provided by operating activities of RMB2,066 million, RMB2,453 million and RMB3,049 million (US\$444 million) in 2016, 2017 and 2018, respectively.

We have received many awards for our business performance, including the Best Hotel Group in 2018 at the 3rd China Travel Consumption Annual Summit, Top one of China's 100 million hotel brand club in 2018 for *HanTing Seasons Hotel* and Top two of China's 100 million hotel brand club in 2018 for *HanTing Hotel* from China Hotel Brand Value List, Most Characteristic Home-stay Brand in 2018 for Blossom Hill Hotels & Resorts from China National Travel magazine, Hotels 50 - Top 50 Most Valuable Hotel Brands in 2017 for *HanTing Hotel* from Brand Finance in 2018, the Top 100 Most Valuable Chinese Brands in 2017 for *HanTing Hotel* from Brandz in 2017, the Golden Horse Awards of China Hotel and the National Brand of China in 2016 and 2017 awards for *HanTing Hotel* from the Review Committee of Golden Horse Awards of China Hotel in 2017, the Top 300 Corporate Hotel Companies award from the HOTELS magazine, the Top 60 Hotel Groups in China in 2015 award from China Tourist Hotels Association, the Best Hotel Management Groups of China award at the 2015 Asia Hotel Forum Annual Meeting and the tenth China Hotel Starlight Awards in 2015, the 2015 China's Best Local Emerging Hotel Brand award for our *Joya Hotel* and the 2015 The Most Popular Newly opened Business Hotel in Northeast China award for our *Joya Hotel Dalian* at the Twelfth Golden-Pillow Award of China Hotels in 2015, the Top 100 Employers certified by 61HR.COM in 2015, the 2015 Best Practice of Public Interest Award at the Fifth China Charity Festival in 2015, the Top 60 China's Hotel Group in 2013 award from China Tourist Hotels Association in 2014, the Industry's Most Influential Brand award from the Third China Finance Summit in 2014.

Our Hotel Network

As of December 31, 2018, we operated 4,230 hotels in China. We have adopted a disciplined return-driven development model aimed at achieving high growth and profitability. As of December 31, 2018, our hotel network covered 403 cities in 32 provinces and municipalities across China. As of December 31, 2018, we had an additional 1,105 leased and owned, manachised and franchised hotels under development.

The following table sets forth a summary of all of our hotels as of December 31, 2018.

	Leased and Owned Hotels	Manachised Hotels	Franchised Hotels	Leased and Owned Hotels Under Development(1)	Manachised and Franchised Hotels Under Development(1)
Shanghai, Beijing, Guangzhou, Shenzhen and Hangzhou	233	874	68	20	195
Other cities	466	2,435	154	22	868
Total	699	3,309	222	42	1,063

(1) Include hotels for which we have entered into binding leases, purchase agreements of land use right or property, or franchise agreements but that have not yet commenced operations. The inactive projects are excluded from this list according to management judgment.

The following table sets forth the status of our hotels under development as of December 31, 2018.

	Pre-conversion Period(1)	Conversion Period(2)	Total
Leased and owned hotels	9	33	42
Manachised and franchised hotels	479	584	1,063
Total	488	617	1,105

Table of Contents

(1) Includes hotels for which we have entered into binding leases or franchise agreements but of which the property has not been delivered by the respective lessors or property owners, as the case may be. The inactive projects are excluded from this list according to management judgment.

(2) Includes hotels for which we have commenced conversion activities but that have not yet commenced operations. The inactive projects are excluded from this list according to management judgment.

Among the 42 leased and owned hotels under development as of December 31, 2018, we had 9 leased and owned hotels during pre-conversion period, for which we have entered into binding leases but of which the property has not been delivered by the respective lessors, and had 33 leased and owned hotels during conversion period, for which we have commenced conversion activities but that have not yet commenced operations. The anticipated completion dates for these leased and owned hotels during conversion period range from January 2019 to November 2019. Total budgeted development costs for these leased and owned hotels during conversion period, which primarily include construction costs for leasehold improvement and the furniture and equipment for hotel operation, were RMB884 million (US\$129 million), of which RMB339 million (US\$49 million) was incurred as of December 31, 2018. The average development costs per square meter for completed leased and owned hotels in 2018 were approximately RMB2,800 (US\$407). The franchisees are responsible for development costs for our manachised hotels and franchised hotels.

Leased and owned hotels

As of December 31, 2018, we had 692 leased hotels and 7 owned hotels, accounting for approximately 16.5% of our hotels in operation. We manage and operate each aspect of these hotels and bear all of the accompanying expenses. We are responsible for recruiting, training and supervising the hotel managers and employees, paying for leases and costs associated with construction and renovation of these hotels, and purchasing all supplies and other required equipment.

Our leased hotels are located on leased properties. The terms of our leases typically range from ten to 20 years. We generally enjoy an initial two- to six-month rent-free period. We generally pay fixed rent on a quarterly or biannual basis for the first three to five years of the lease term, after which we are generally subject to a 3% to 5% increase every three to five years. Our leases usually allow for extensions by mutual agreement. In addition, our lessors are typically required to notify us in advance if they intend to sell or dispose of their properties, in which case we have a right of first refusal to purchase the properties on equivalent terms and conditions. 24 of our leases expired in 2018, among which 14 were renewed, one was converted to manachised and franchised hotels and nine were closed. As of December 31, 2018, 31 of our leases were expected to expire in 2019. Two of these 31 leases have been renewed, six of these 31 leases have been terminated and the rest of these 31 leases are subject to negotiation as of the date of this annual report.

The following table sets forth the number of our leases for hotels in operation and under development due to expire in the periods indicated as of December 31, 2018.

	Number of Leases
2019	31
2020	41
2021	49
2022	69
2023	57
2024-2026	186
2027-2029	162
2030 and onward	138
Total	733

Manachised hotels

As of December 31, 2018, we had 3,309 manachised hotels, accounting for approximately 78.3% of our hotels in operation. The franchisees of our manachised hotels either lease or own their hotel properties and are required to invest in the renovation of their properties according to our product standards. We manage our manachised hotels and impose the same standards on all manachised hotels to ensure product quality and consistency across our hotel network. We appoint and train hotel managers who are responsible for hiring hotel staff and managing daily operation. We also provide our franchisees with services such as central reservation, sales and marketing support, quality assurance inspections and other operational support and information. Our franchisees are responsible for the costs of developing and operating the hotels, including renovating the hotels to our standards, and all of the operating expenses. We believe the manachise model has enabled us to quickly and effectively expand our geographical coverage and market share in a less capital-intensive manner through leveraging the local knowledge and relationships of our franchisees.

Table of Contents

We collect fees from the franchisees of our manachised hotels and do not bear any loss or share any profit incurred or realized by our franchisees. They are also responsible for all costs and expenses related to hotel construction and refurbishing. Our franchise and management agreements for our manachised hotels typically run for an initial term of eight to ten years.

Our franchisees are generally required to pay us a one-time franchise fee typically ranging between RMB80,000 and RMB500,000. In general, we charge a monthly franchise fee of approximately 5% to 6.5% of the gross revenues generated by each manachised hotel. We also collect from franchisees a reservation fee for using our central reservation system and a membership registration fee to service customers who join our HUAZHU Rewards loyalty program at the manachised hotels. Furthermore, we employ, appoint and train hotel managers for our manachised hotels and charge the franchisees a monthly fee for services we provide.

Franchised hotels

As of December 31, 2018, we had 222 franchised hotels, accounting for approximately 5.2% of our hotels in operation. We collect fees from the franchisees of our franchised hotels and do not bear any loss or share any profit incurred or realized by our franchisees. Services we provide to our franchised hotels generally include training, central reservation, sales and marketing support, quality assurance inspections and other operational support and information. We do not appoint hotel managers for our franchised hotels.

Our hotel chain has grown rapidly since we began migrating to our current business of operating and managing a multi-brand hotel group in 2007. The following table sets forth the number of hotels we operated as of the dates indicated.

	2009	2010	2011	2012	As of December 31,		2015	2016	2017	2018
					2013	2014				
Leased and owned hotels	173	243	344	465	565	611	616	624	671	699
Manachised hotels	63	195	295	516	835	1,376	2,067	2,471	2,874	3,309
Franchised hotels				54	25	8	80	174	201	222
Total	236	438	639	1,035	1,425	1,995	2,763	3,269	3,746	4,230

Our Products

We began our current business of operating and managing a multi-brand hotel group in 2007. As of the date of this annual report, we own 12 hotel brands that are designed to target distinct segments of customers:

- *Hi Inn*, our budget hotel product which targets practical and price-conscious travelers, originally marketed under the name of *HanTing Hi Inn*;

- *HanTing Hotel*, our economy hotel product which targets knowledge workers and value- and quality-conscious travelers, originally marketed under the name of HanTing Express Hotel;
- *Elan Hotel*, our economy hotel product which targets business travelers, young customers and urban tourists. *Elan Hotel* is committed to provide a unique business and travel life experience for its guests;
- *Orange Hotel*, our economy brand, features three-star standard facilities at affordable prices;
- *HanTing Premium*, our entry-level midscale hotel brand targeting middle class leisure travelers and midscale corporate events;

Table of Contents

- *Starway Hotel*, our midscale limited service hotel product with variety in design and consistency in quality which targets middle class travelers who seek a spacious room, reasonable price and guaranteed quality;
- *JI Hotel*, our standardized midscale limited service hotel product which targets mature and experienced travelers who seek a quality experience in hotel stays, previously marketed first under the name of *HanTing Hotel* and then HanTing Seasons Hotel;
- *Orange Hotel Select*, our midscale hotel brand, is the mini version of our *Crystal Orange Hotel*;
- *Manxin Hotel*, our mid-to-upscale hospitality brand including city hotels and resorts. Manxin Hotel targets business travelers, leisure travelers, families and corporate events;
- *Crystal Orange Hotel*, our mid-to-upscale hotel brand, features boutique design hotels equipped with advanced, five-star standard facilities; and
- *Joya Hotel*, our upscale brand concept targeting affluent travelers and corporate events. Joya hotels are typically located in central business districts.
- *Blossom Hill Hotels & Resorts*, our upscale lifestyle and resort brand targeting affluent travelers. Most of Blossom Hill s hotels are located near typical scenic spots.

In addition to the 12 hotel brands owned by us, we have also entered into brand franchise agreements with Accor and enjoyed exclusive franchise rights in respect of *Mercure* , *Ibis* and *Ibis Styles* in the PRC, Taiwan and Mongolia and non-exclusive franchise rights in respect of *Grand Mercure* and *Novotel* in the PRC, Taiwan and Mongolia:

- *Ibis*, an economy hotel brand that is recognized across the world for its quality, reliability and commitment to the environment.
- *Ibis Styles*, a midscale brand that offers comfortable, designer hotels at an all-inclusive rate;

- *Mercure*, a midscale hotel brand that targets business and leisure travelers around the world;
- *Novotel*, a mid-to-upscale brand that provides a multi-service offer for both business and leisure guests; and
- *Grand Mercure*, a brand that offers an upscale network of hotels and apartments that combine local culture with world-class services.

We believe that our multi-brand strategy provides us with a competitive advantage by (i) enabling us to open a larger number of hotels in attractive markets, (ii) capturing a greater share of the spending of customers whose lodging needs may change from occasion to occasion or evolve over time, and (iii) providing us a greater benefit of economy of scale through shared platforms.

Hi Inn

Launched in late 2008 and originally marketed under the name of *HanTing Hi Inn*, Hi Inns target rational and price-conscious travelers. These hotels offer compact rooms with comfortable beds and shower facilities and complimentary wireless Internet access throughout the premises. These hotels provide basic and clean accommodations. As of December 31, 2018, we had 402 Hi Inns in operation and an additional 25 Hi Inns under development.

HanTing Hotel

Launched in 2007 and originally marketed under the name of *HanTing Express Hotel*, *HanTing Hotel* is our economy hotel product with the value proposition of Quality, Convenience and Value. These hotels are typically located in areas close to major business and commercial districts. The *HanTing Hotel* targets knowledge workers and value- and quality-conscious travelers. These hotels are equipped with complimentary wireless Internet access and laser printers, and a cafe serving breakfast and simple meals. As of December 31, 2018, we had 2,283 HanTing Hotels in operation and an additional 220 HanTing Hotels under development.

Table of Contents

Elan Hotel

In September 2014, we launched *Elan Hotel*. *Elan Hotel* is our economy hotel product which targets business travelers, young customers and urban tourists, and is committed to provide a unique business and leisure life experience for the hotel guests. The hotels' modern and nature design elements create a fresh and refreshing atmosphere for the hotel guests. *Elan Hotel* brand conveys the concept of enjoyment of life and nature. As of December 31, 2018, we had 200 *Elan Hotels* in operation and an additional 27 *Elan Hotels* under development.

Orange Hotel

Orange Hotel is our economy brand. These hotels feature three-star standard facilities at affordable prices. As of December 31, 2018, we had seven *Orange Hotels* in operation and no additional *Orange Hotels* under development.

HanTing Premium

Upgraded from *HanTing Hotel*, *HanTing Premium* is our entry-level midscale hotel brand targeting middle class leisure travelers. These hotels offer 24/7 Niice Cafe, ready-to-go breakfast and a variety of self-service facilities, including self-check-in/self-check-out kiosks, self-service lockers and self-service laundry facilities, providing convenience at both leisure and corporate levels. As of December 31, 2018, we had 74 *HanTing Premium Hotels* in operation and an additional 94 *HanTing Premium Hotels* under development.

Starway Hotel

Starway Hotel varies in their designs and targets middle class travelers who seek a spacious room, reasonable price and guaranteed quality. *Starway Hotels* offer rooms with a quality comparable to three- to four-star hotels, but are priced at competitive rates. In addition, these hotels typically offer complimentary Internet access throughout the premises, spacious lobbies and meeting areas with complimentary tea and coffee. As of December 31, 2018, we had 212 *Starway Hotels* in operation and an additional 75 *Starway Hotels* under development.

Ji Hotel

Ji Hotel, which was previously marketed first under the name of *HanTing Hotel* and then *HanTing Seasons Hotels*, is typically located in city centers or central business districts. These hotels target travelers who seek a quality experience in hotel stays. Ji Hotels offer rooms with a quality comparable to three- to four-star hotels, but are priced at competitive rates. In addition, these hotels offer complimentary wireless Internet access throughout the premises, spacious lobbies with laser printers, computers, free drinks, and a cafe serving breakfast and simple meals. As of December 31, 2018, we had 553 Ji Hotels in operation and an additional 282 Ji Hotels under development.

Orange Hotel Select

Orange Hotel Select is our midscale hotel brand. These hotels are mini versions of our Crystal Orange Hotels with advanced sound-proof design. As of December 31, 2018, we had 172 hotels branded *Orange Hotel Select* in operation and an additional 96 hotels branded *Orange Hotel Select* under development.

Manxin Hotel

Manxin Hotels & Resorts was launched as a brand of resorts in October 2013, and was subsequently rebranded as *Manxin Hotel*. Nowadays *Manxin Hotel* is becoming a brand with city hotels and resorts. These hotels are typically located in city center or business districts and holiday resort areas. *Manxin Hotel* offers high quality rooms, intelligent service system, rich breakfast, lunch, afternoon tea, dinner and even coffee and drinks. Moreover, *Manxin Hotel* is aimed to bring the guests a distinct experience by presenting amazing space design and attractive activities. Live Lively is *Manxin Hotel*'s proposition. As of December 31, 2018, we had 24 Manxin Hotels in operation and an additional 26 Manxin Hotels under development.

Crystal Orange Hotel

Crystal Orange Hotel is our mid-to-upscale hotel brand featuring boutique design hotels. These hotels are equipped with advanced, five-star standard facilities, including free high-speed wireless internet access, intelligent lighting system, wireless speakers and sound-proof design. As of December 31, 2018, we had 56 Crystal Orange Hotels in operation and an additional 36 Crystal Orange Hotels under development.

Table of Contents

Joya Hotel

In December 2013, we launched *Joya Hotel*. These hotels are typically located in areas close to major business and commercial districts in first and second tier cities and target affluent travelers and corporate events. *Joya Hotel* is designed for guests to enjoy an all-inclusive service, including complimentary breakfast, afternoon tea, healthy snack, mini bar free drinks, gym, automatic massage cabins and other premium services. The rooms are equipped with high-speed fiber access, full wireless coverage and Bluetooth speakers. As of December 31, 2018, we had six Joya Hotels in operation and an additional four Joya Hotels under development.

Blossom Hill Hotels & Resorts

Blossom Hill Hotels & Resorts is our upscale lifestyle and resort band targeting affluent travelers. Most of Blossom Hill's hotels are located near typical scenic spots. As of December 31, 2018, we have 18 Blossom Hill Hotels in operation and an additional 17 Blossom Hill Hotels under development.

Grand Mercure Hotel

Grand Mercure is a brand that offers an upscale network of hotels and apartments that combine local culture with world-class services. With hotels that are uniquely adapted to each market, the brand helps guests discover a new authentic . As of December 31, 2018, we had six Grand Mercure Hotels in operation and additional seven Grand Mercure Hotels under development.

Novotel Hotel

Novotel is a mid-to-upscale brand that provides a multi-service offer for both business and leisure guests, with spacious, modular rooms, 24/7 catering offers with balanced meals, meeting rooms, attentive and proactive staff, kid areas, a multi-purpose lobby and fitness centers. These hotels are typically located in the heart of major international cities, business districts and tourist destinations. As of December 31, 2018, we had seven Novotel Hotels in operation and an additional ten Novotel Hotels under development.

Mercure Hotel

Mercure is a midscale hotel brand that combines the strength of an international network with a strong quality commitment with the warm experience of hotels that are rooted in their local community, targeting business and

leisure travelers around the world. These hotels are typically located in city centers, by the sea or in the mountains. As of December 31, 2018, we had 39 Mercure Hotels in operation and an additional 69 Mercure Hotels under development.

Ibis Styles Hotel

Ibis Styles is a midscale brand that offers comfortable, designer hotels typically located in city centers or close to activity centers. The brand's distinctive all-inclusive package includes the room, all-you-can-eat breakfast buffet and broadband Internet connection, plus a host of little extras. As of December 31, 2018, we had 34 Ibis Styles Hotels in operation and an additional 29 Ibis Styles Hotels under development.

Ibis Hotel

Ibis is an economy hotel brand that is recognized across the world for its quality, reliability and commitment to the environment. It created the revolutionary bedding concept Sweet Bed™ by *ibis* and features welcoming, designer common areas and the modern food and beverage offer, *ibis* kitchen. As of December 31, 2018, we had 137 Ibis Hotels in operation and an additional 81 Ibis Hotels under development.

Table of Contents

Hotel Development

We mainly use the manachise and franchise models to expand our network in a less capital-intensive manner. We also lease the properties of the hotels we operate. Other than the properties we acquired as part of our strategic alliance with Accor in 2016 and from our acquisition of Blossom Hill, we typically do not acquire properties ourselves, as owning properties is generally much more capital intensive. We have adopted a systematic process with respect to the planning and execution of new development projects. Our development department analyzes economic data by city, field visit reports and market intelligence information to identify target locations in each city and develop a three-year development plan for new hotels on a regular basis. The plan is subsequently reviewed and approved by our investment committee. Once a property is identified in the targeted location, staff in our development department analyzes the business terms and formulates a proposal for the project. In the case of a lease opportunity, the investment committee evaluates each proposed project based on several factors, including the length of the investment payback period, the rate of return on the investment, the amount of net cash flow projected during the operating period and the impact on our existing hotels in the vicinity. When evaluating potential manachising and franchising opportunities, the investment committee considers the attractiveness of the location as well as additional factors such as quality of the prospective franchisee and product consistency with our standards. Our investment committee weighs each investment proposal carefully to ensure that we can effectively expand our coverage while concurrently improving our profitability.

The following is a description of our hotel development process.

Manachised and franchised hotels

We open manachised and franchised hotels to expand our geographical coverage or to deepen penetration of existing markets. Manachised and franchised hotels provide us valuable operating information in assessing the attractiveness of new markets, and supplement our coverage in areas where the potential franchisees can have access to attractive locations by leveraging their own assets and local network. As is the case with leased and owned hotels, we generally look to establish manachised and franchised hotels near popular commercial and office districts that tend to generate stronger demand for hotel accommodations. Manachised and franchised hotels must also meet certain specified criteria in connection with the infrastructure of the building, such as adequate water, electricity and sewage systems.

We typically source potential franchisees through word-of-mouth referrals, applications submitted via our website and industry conferences. Some of our franchisees operate several of our manachised and franchised hotels. In general, we seek franchisees who share our values and management philosophies.

We typically supervise the franchisees in designing and renovating their properties pursuant to the same standards required for our leased and owned hotels, and provide assistance as required. We also provide technical expertise and require

the franchisees to follow a pre-selected list of qualified suppliers. In addition, we appoint or train hotel managers and help train other hotel staff for our manachised hotels to ensure that high quality and consistent service is provided throughout all our hotels.

Leased and owned hotels

We seek properties that are in central or highly accessible locations in economically more developed cities in order to maximize the room rates that we can charge. In addition, we typically seek properties that will accommodate hotels of 80 to 300 rooms.

After identifying a proposed site, we conduct thorough due diligence and typically negotiate leases concurrently with the lessors. All leases and development plans are subject to the final approval of our investment committee. Once a lease agreement has been executed, we then engage independent design firms and construction companies to begin work on leasehold improvement. Our construction management team works closely with these firms on planning and architectural design. Our contracts with construction companies typically contain warranties for quality and requirements for timely completion of construction. Contractors or suppliers are typically required to compensate us in the event of delays or poor work quality. A majority of the construction materials and supplies used in the construction of our new hotels are purchased by us through a centralized procurement system.

Hotel Management

Our management team has accumulated significant experience with respect to the operation of hotels. Building on this experience, our management team has developed a robust operational platform for our nationwide operations, implemented a rigorous budgeting process, and utilized our information systems to monitor our hotel performance. We believe the system is critical in maximizing our revenues and profitability. The following are some of the key components of our hotel management system:

Table of Contents

Budgeting. Our budget and analysis team prepares a detailed annual cost and revenue budget for each of our leased and owned hotels, and an annual revenue budget for each of our manachised and franchised hotels. The hotel budget is prepared based on, among other things, the historical operating performance of each hotel, the performance of comparable hotels and local market conditions. We may adjust the budget upon the occurrence of unexpected events that significantly affect a specific hotel's operating performance. In addition, our compensation scheme for managers in each hotel is directly linked to its performance against the annual budget.

Pricing. Our room rates are determined using a centralized system and are based on the historical operating performance of each of our leased and owned and manachised hotels, our competitors' room rates and local market conditions. We adjust room rates regularly based on seasonality and market demand. We also adjust room rates for certain events, such as the China Import and Export Fair held twice a year in Guangzhou and the World Expo in Shanghai in 2010. We believe our centralized pricing system enhances our ability to adjust room rates in a timely fashion with a goal of optimizing average daily rates and occupancy levels across our network. Room rates for our franchised hotels are determined by the franchisees based on local market condition.

Monitoring. Through the use of our web-based property management system, we are able to monitor each hotel's occupancy status, average daily rates, RevPAR and other operating data on a real-time basis. Real-time hotel operating information allows us to adjust our sales efforts and other resources to rapidly capitalize on changes in the market and to maximize operating efficiency.

Centralized cash management. Our leased and owned hotels deposit cash into our central account several times a week. We also generally centralize all payments for expenditures. Our manachised and franchised hotels manage their cash separately.

Centralized procurement system. Our centralized procurement system has enabled us to efficiently manage our operating costs, especially with respect to supplies used in large quantities. Given the scale of our hotel network and our centralized procurement system, we have the purchasing power to secure favorable terms from suppliers for all of our hotels.

Quality assurance. We have developed an operating manual to which our staff closely adhere to ensure the consistency and quality of our customer experience. We conduct periodic internal quality checks of our hotels to ensure that our operating policies and procedures are followed. We also engage mystery guests from time to time to ensure that we are providing consistent quality services. Furthermore, we actively solicit customer feedbacks by conducting outbound e-mail surveys and monitor customer messages left in hotel guestbooks as well as comments posted on our website and third-party websites.

Training. We view the quality and skill sets of our employees as essential to our business and thus have made employee training one of our top priorities. Our HuaZhu University, previously known as HanTing College, together with our regional management teams, offers structured training programs for our hotel managers, other hotel-based staff and corporate staff. Our hotel managers are required to attend a three-week intensive training program, covering topics such as our corporate culture, team management, sales and marketing, customer service, hotel operation standards and financial and human resource management. Approximately 80% of our hotel managers have received training completion certificates. Our HuaZhu University also rolled out a new-hire training package in October 2009 to standardize the training for hotel-based staff across our hotel group. In addition, we provide our corporate staff with various training programs, such as managerial skills, office software skills and corporate culture. In 2018, our hotel-based staff and corporate staff on average have received approximately 60 and 48 hours of training, respectively.

Hotel Information Platform and Operational Systems

We have successfully developed and implemented an advanced operating platform capable of supporting our nationwide operations. This operating platform enables us to increase the efficiency of our operations and make timely decisions. The following is a description of our key information and management systems.

Table of Contents

Web property management system (Web-PMS). Our Web-PMS is a web-based, centralized application that integrates all the critical operational information in our hotel network. This system enables us to manage our room inventory, reservations and pricing for all of our hotels on a real-time basis. The system is designed to enable us to enhance our profitability and compete more effectively by integrating with our central reservation system and customer relationship management system. We believe our Web-PMS enables our management to more effectively assess the performance of our hotels on a timely basis and to efficiently allocate resources and effectively identify specific market and sales targets.

Central reservation system. We have a real-time central reservation system available 24 hours a day, seven days a week. Our central reservation system allows reservations through multiple channels including our website, mobile apps, call center, third-party travel agents and online reservation partners. The real-time inventory management capability of the system improves the efficiency of reservations, enhances customer satisfaction and maximizes our profitability.

Customer relationship management (CRM) system. Our integrated CRM system maintains information of our HUAZHU Rewards members, including reservation and consumption history and pattern, points accumulated and redeemed, and prepayment and balance. By closely tracking and monitoring member information and behavior, we are able to better serve the members of our loyalty program and offer targeted promotions to enhance customer loyalty. The CRM system also allows us to monitor the performance of our corporate client sales representatives.

Internet service system. Our Internet service system consists of our website (www.huazhu.com), our mobile website (m.huazhu.com) and our mobile apps for smart phones running iOS, Android or other systems. The system provides our HUAZHU Rewards members and the general public with convenient, friendly and updated services, including information and search services for our hotels, such as location, amenities and pricing, reservation services, online payment and online room selection functions, membership registration and management and member community services. Our members can reload their individual account balance through the system as well. Our mobile apps also provide location-based services, including search services for our nearby hotels.

We place a strong emphasis on data security. We have established an information security committee, which focuses on ensuring the security of customer data and preventing data leakage by formulating policies and procedures and providing us with data protection related guidance. We also have a dedicated information security center equipped with personnel specialized in data security, compliance and risk management. This center is involved in key aspects of our business operations and provides other departments with professional data security and risk management services.

We have in place extensive policies, processes, network architecture, and software to protect customer data. Our major systems, including those regarding property management, customer relationship management and payments, as well as our website and mobile apps, have passed the Level III information security protection assessment conducted by the China National Accreditation Service for Conformity Assessment. Our credit card payment system has passed the payment card industry (PCI) data security standard (DSS) requirements and security assessment procedures assessment. In addition, we collaborate with a renowned European information security company to strengthen the infrastructure of our IT and information systems and ensure compliance with data protection laws and regulations in the EU and China, such as the GDPR.

We have a dedicated team of professionals who conduct regular security testing on our systems and address system errors and bugs; and a dedicated maintenance team for the maintenance of our systems, servers and databases. We also collaborate with renowned information security companies regarding 24/7 system monitoring, emergency response, and other expert consultation, to further strengthen our data security.

Sales and Marketing

Our marketing strategy is designed to enhance our brand recognition and customer loyalty. Building and differentiating the brand image of each of our hotel products is critical to increasing our brand recognition. We focus on targeting the distinct guest segments that each of our hotel products serves and adopting effective marketing measures based on thorough analysis and application of data and analytics. In 2018, approximately 86% of our room nights were sold through our own sales platforms and the remaining 14% of our room nights through intermediaries.

Table of Contents

We use our Web-PMS system to conduct pricing management for all of our hotels except for our franchised hotels. We review our hotel pricing regularly and adjust room rates as needed based on local market conditions and the specific location of each hotel, focusing mainly on three factors: (i) optimum occupancy rate of the hotel and our other hotels nearby, (ii) seasonal demand for the hotel and (iii) event-driven demand for the hotel.

A key component of our marketing efforts is the HUAZHU Rewards, our loyalty program, which covers all of our brands. We believe the HUAZHU Rewards loyalty program allow us to build customer loyalty and conduct lower-cost, targeted marketing campaigns. A majority of individual members of the HUAZHU Rewards pay to enroll in the program. As of December 31, 2018, our HUAZHU Rewards had more than 120 million members. In 2018, approximately 76% of our room nights were sold to our HUAZHU Rewards members. Members of the HUAZHU Rewards are provided with discounts on room rates, free breakfasts (for gold and platinum members), more convenient check-out procedures and other benefits. HUAZHU Rewards members can also accumulate points through stays in our hotels or by purchasing products and services provided at our hotels. These points can be used to offset the room charges in our hotels, buy products in Hua Zhu mall, book transportations and tickets through our platform or be redeemed for various coupons. We also have joint promotional programs with leading financial institutions and airlines to recruit new members of our loyalty program. The HUAZHU Rewards includes five levels of membership: star, silver, rose gold, gold and platinum. Star membership is the entry level and can be obtained from online registration for free. We charge RMB49 as the one-time membership fee for the silver membership. The one-time membership fee for the gold membership is RMB219 or RMB170, if purchased as an existing silver member. Star members and silver members may obtain gold membership by recharging their HUAZHU Rewards accounts, or binding their corporate membership cards to their existing membership. Rose gold membership is for employees of the corporate members of the HUAZHU Rewards and can be obtained by binding their respective corporate membership cards. Memberships can be upgraded to the next level or renewed upon the satisfaction of certain conditions. HUAZHU Rewards was previously known as HanTing Club and HuaZhu Club.

Our marketing activities also include Internet advertising, press and sponsored activities held jointly with our corporate partners and advertisements on travel and business magazines.

Competition

The lodging industry in China is highly fragmented. A significant majority of the room supply has come from stand-alone hotels, guest houses and other lodging facilities. In recent years hotel groups emerged and began to consolidate the market by converting standalone hotels into members of their hotel groups. As a multi-brand hotel group we believe that we compete primarily based on location, room rates, brand recognition, quality of accommodations, geographic coverage, service quality, range of services, guest amenities and convenience of the central reservation system. We primarily compete with other hotel groups as well as various stand-alone lodging facilities in each of the markets in which we operate. Our HanTing Hotels, Orange Hotels, Ibis Hotels and Elan Hotels mainly compete with Home Inns, Jinjiang Inn, 7 Days Inn, various regional hotel groups and stand-alone hotels, and certain international brands such as Super 8 and OYO hotels. HanTing Hotels, Orange Hotels and Ibis Hotels also compete with two- and three-star hotels, as they offer rooms with amenities comparable to many of those hotels. Our JI Hotels, Starway Hotels, Orange Hotels Select, HanTing Premium Hotels, Ibis Styles Hotels, Mercure Hotels and Novotel Hotels face competition from existing three-star and certain four-star hotels, boutique hotels whose price could be comparable and a few hotel chains such as

Vienna Hotels, Atour Hotels, Hampton Hotels and Holiday Inn Express. Our Hi Inns compete mainly with stand-alone guest houses, low-price hotels and budget hotel chains such as Pod Inns, 99 Inns and 100 Inns. Our Joya Hotels, Manxin Hotels and Grand Mercure Hotels compete with existing four-star and five-star hotels. Our Manxin Hotels, Crystal Orange hotels and Blossom Hill Hotels also compete with boutique resort hotels.

Intellectual Property

We regard our trademarks, copyrights, domain names, trade secrets and other intellectual property rights as critical to our business. We rely on a combination of copyright and trademark law, trade secret protection and confidentiality agreements with our employees, lecturers, business partners and others, to protect our intellectual property rights.

As of March 31, 2019, we registered 702 trademarks and logos with the China Trademark Office. The trademarks and logos used in our current hotels are under protection of the registered trademarks and logos. As of March 31, 2019, an additional 161 trademark applications were under review by the authority. As of the same date, we also registered 10 trademarks in South Korea, 17 trademarks in Taiwan, 22 trademarks in Hong Kong, 10 trademarks in Malaysia, 1 trademark in New Zealand, 4 trademarks in Japan, 10 trademarks in Australia, 5 trademarks in Singapore, and 5 trademarks in Macau. We filed 12 trademark applications in each of Japan, Vietnam, Indonesia and Thailand, 10 trademark applications in Taiwan, 14 trademark applications in Singapore, 2 trademark applications in each of USA and Malaysia. As of March 31, 2019, we received nine patents; another 13 patents were applied and were under review in the PRC. We also received copyright registration certificates for 63 software programs developed by us as of March 31, 2019. In addition, we registered 155 national and international top-level domain names, including www.htinns.com, www.hantinghotels.com and www.huazhu.com as of March 31, 2019. Our intellectual property is subject to risks of theft and other unauthorized use, and our ability to protect our intellectual property from unauthorized use is limited. In addition, we may be subject to claims that we have infringed the intellectual property rights of others. See Item 3. Key Information D. Risk Factors Risks Related to Our Business Failure to protect our trademarks and other intellectual property rights could have a negative impact on our brand and adversely affect our business.

Table of Contents

Insurance

We believe that our hotels are covered by adequate property and liability insurance policies with coverage features and insured limits that we believe are customary for similar companies in China. We also require our franchisees to carry adequate property and liability insurance policies. We carry property insurance that covers the assets that we own at our hotels. Although we require our franchisees to purchase customary insurance policies, we cannot guarantee that they will adhere to such requirements. If we were held liable for amounts and claims exceeding the limits of our insurance coverage or outside the scope of our insurance coverage, our business, results of operations and financial condition may be materially and adversely affected. See Item 3. Key Information D. Risk Factors Risks Related to Our Business Our limited insurance coverage may expose us to losses, which may have a material adverse effect on our reputation, business, financial condition and results of operations.

Legal and Administrative Proceedings

In the ordinary course of our business, we, our directors, management and employees are subject to periodic legal or administrative proceedings. Although we cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against us, our directors, management and employees, we do not believe that any currently pending legal or administrative proceeding to which we, our directors, management and employees are a party will have a material adverse effect on our business or reputation. See Item 3. Key Information D. Risk Factors Risks Related to Our Business We, our directors, management and employees may be subject to certain risks related to legal proceedings filed by or against us, and adverse results may harm our business.

In October 2018, a proposed class action complaint was filed with the United States District Court in the Central District of California against us and our management alleging violations of the U.S. securities laws in relation to a possible data breach in August 2018. This case was voluntarily dismissed by the plaintiffs on February 27, 2019.

As of December 31, 2018, we had several pending legal and administrative proceedings, including lease contract terminations and disputes and construction contract disputes. As of the same date, our accrued contingencies remained was RMB20 million (US\$3 million).

Corporate Social Responsibility: Environmental Impact

We are committed to reducing our environmental footprint through various energy saving initiatives. For example, most of our hotels use LED lights and are equipped with eco-friendly air source heat pump systems and solar energy systems. We also encourage customers staying for more than one night to reuse towels and bed sheets.

In addition, we have established an online energy consumption management system to timely and accurately track our hotels' energy consumption, including electricity, water and gas consumption. This system helps us monitor the consumption level and cost per room night and detect abnormal energy usage patterns. By analyzing data collected by this system, we are able to come up with energy-saving solutions and improve the overall energy efficiency of our hotels.

Table of Contents**Regulation**

The hotel industry in China is subject to a number of laws and regulations, including laws and regulations relating specifically to hotel operation and management and commercial franchising, as well as those relating to environmental and consumer protection. The principal regulation governing foreign ownership of hotel businesses in the PRC is the *Foreign Investment Industrial Guidance Catalogue* issued by the National Development and Reform Commission and the PRC Ministry of Commerce, or the MOC, which was most recently updated on July 28, 2018. Pursuant to this regulation, there are no restrictions on foreign investment in limited service hotel businesses in China aside from business licenses and other permits that every hotel must obtain. Relative to other industries in China, regulations governing the hotel industry in China are still developing and evolving. As a result, most legislative actions have consisted of general measures such as industry standards, rules or circulars issued by different ministries rather than detailed legislations. This section summarizes the principal PRC regulations currently relevant to our business and operations.

Regulations on Hotel Operation

The Ministry of Public Security issued the *Measures for the Control of Security in the Hotel Industry* in November 1987 and amended it in 2011, and the State Council promulgated the *Decision of the State Council on Establishing Administrative License for the Administrative Examination and Approval Items Really Necessary To Be Retained* in June 2004 and amended it in January 2009 and August 2016, respectively. Under these two regulations, anyone who applies to operate a hotel is subject to examination and approval by the local public security authority and must obtain a special industry license. The Measures for the Control of Security in the Hotel Industry impose certain security control obligations on the operators. For example, the hotel must examine the identification card of any guest to whom accommodation is provided and make an accurate registration. The hotel must also report to the local public security authority if it discovers anyone violating the law or behaving suspiciously or an offender wanted by the public security authority. Pursuant to the *Measures for the Control of Security in the Hotel Industry*, hotels failing to obtain the special industry license may be subject to warnings or fines of up to RMB200. In addition, pursuant to various local regulations, hotels failing to obtain the special industry license may be subject to warnings, orders to suspend or cease continuing business operations, confiscations of illegal gains or fines.

The State Council promulgated the *Public Area Hygiene Administration Regulation* in April 1987 and amended it in February 2016, according to which, a hotel must obtain a public area hygiene license before opening for business. Pursuant to this regulation, hotels failing to obtain a public area hygiene license may be subject to the following administrative penalties depending on the seriousness of their respective activities: (i) warnings; (ii) fines; or (iii) orders to suspend or cease continuing business operations. In March 2011, the Ministry of Health promulgated the *Implementation Rules of the Public Area Hygiene Administration Regulation*, which was amended in January 2016 and December 2017, according to which, starting from May 1, 2011, hotel operators shall establish hygiene administration system and keep records of hygiene administration. The Standing Committee of the National People's Congress, or the SCNPC enacted the *PRC Law on Food Safety* in February 2009, which was most recently amended in December 2018, according to which any hotel that provides food must obtain a license. China Food and Drug Administration, or the CFDA, enacted the *Regulation on Administration of Food Business Permit* in August 2015 and amended it in November 2017, according to which any entity involving sales of food or food services must obtain a food business license, and any food service license which had obtained prior to October 1, 2015 will be replaced upon expiry by the food business license. Pursuant to this law, hotels failing to obtain the food business license (or formerly the food service license) may be subject to: (i) confiscation of illegal gains, food illegally produced for sale and tools, facilities and raw materials used for illegal production; or (ii) fines between RMB50,000 and RMB100,000 if the value of food illegally produced is less than RMB10,000 or fines equal to 1000% to 2000% of the value of food if such value is equal to or more than RMB10,000.

The Fire Prevention Law, as amended by the SCNPC in October 2008, and the *Provisions on Supervision and Inspection on Fire Prevention and Control*, promulgated by the Ministry of Public Security and effective as of May 1, 2009 and was amended on November 1, 2012, require that public gathering places such as hotels submit a fire prevention

design plan to apply for the completion acceptance of fire prevention facilities for their construction projects and to pass a fire prevention safety inspection by the local public security fire department, which is a prerequisite for opening business. Pursuant to these regulations, hotels failing to obtain approval of fire prevention design plans or failing fire prevention safety inspections may be subject to: (i) orders to suspend the construction of projects, use or operation of business; and (ii) fines between RMB30,000 and RMB300,000.

Table of Contents

In January 2006, the State Council promulgated the *Regulations for Administration of Entertainment Places*, which was amended in February 2016. The Ministry of Culture issued the *Circular on Carrying Out the Regulations for Administration of Entertainment Places* in March 2006 and the *Administrative Measures for Entertainment Places* in February 2013 (amended in December 2017). Under these regulations, hotels that provide entertainment facilities, such as discos or ballrooms, are required to obtain a license for entertainment business operations.

On October 18, 2010, the General Administration of Quality Supervision, Inspection and Quarantine and Standardization Administration approved and issued *Classification and Accreditation for Star-rated Tourist Hotels* (GB/T14308-2010), which became effective on January 1, 2011. On November 19, 2010, the National Tourist Administration promulgated the *Implementation Measures of Classification and Accreditation for Star-rated Tourist Hotels*, which became effective on January 1, 2011. Under these regulations, all hotels with operations of over one year are eligible to apply for a star rating assessment. There are five ratings from one star to five stars for tourist hotels, assessed based on the level of facilities, management standards and quality of service. A star rating, once granted, is valid for three years.

On September 21, 2012, the Ministry of Commerce promulgated the *Provisional Administrative Measures for Single-purpose Commercial Prepaid Cards*, according to which, if an enterprise engaged in retail, accommodation and catering, or residential services issues any single-purpose commercial prepaid card to its customers, it shall undergo a record-filing procedure. For a hotel primarily engaged in the business of accommodation, the aggregate balance of the advance payment under the single-purpose commercial prepaid cards it issued shall not exceed 40% of its income from its primary business in the previous financial year.

On April 25, 2013, the Standing Committee of the National People's Congress issued the *Tourism Law of the People's Republic of China*, which became effective on October 1, 2013 and was most recently amended on October 26, 2018. According to this law, the accommodation operators shall fulfill their obligations under the agreements with consumers. If the accommodation operators subcontract part of their services to any third party or involve any third party to provide services to customers, the accommodation operators shall assume the joint and several liabilities with the third parties for any damage caused to the customers.

Regulations on Leasing

Under the *Law on Urban Real Estate Administration* promulgated by the SCNPC, which took effect as of January 1995 and was amended in August 2007 and August 2009, respectively, and the *Administrative Measures for Commodity House Leasing* promulgated by the Ministry of Housing and Urban-rural Construction, which took effect as of February 1, 2011, when leasing premises, the lessor and lessee are required to enter into a written lease contract, prescribing such provisions as the leasing term, use of the premises, rental and repair liabilities, and other rights and obligations of both parties. Both lessor and lessee are also required to go through registration procedures to record the lease with the real estate administration department. Pursuant to these laws and regulations and various local regulations, if the lessor and lessee fail to go through the registration procedures, both lessor and lessee may be subject to fines, and the leasing interest will be subordinated to an interested third party acting in good faith.

In March 1999, the National People's Congress, the China legislature, passed the *PRC Contract Law*, of which Chapter 13 governs lease agreements. According to the *PRC Contract Law*, subject to consent of the lessor, the lessee may sublease the leased item to a third party. Where the lessee subleases the lease item, the leasing contract between the lessee and the lessor remains valid. The lessor is entitled to terminate the contract if the lessee subleases the lease item without the consent of the lessor.

In March 16, 2007, the National People's Congress passed the *PRC Property Law*, pursuant to which where a mortgagor leases the mortgaged property before the mortgage contract is concluded, the previously established leasing relation shall not be affected; and where a mortgagor leases the mortgaged property after the creation of the mortgage interest, the leasing interest will be subordinated to the registered mortgage interest.

Regulations on Consumer Protection

In October 1993, the SCNPC promulgated the *Law on the Protection of the Rights and Interests of Consumers*, or the Consumer Protection Law, which became effective on January 1, 1994 and was amended on March 15, 2014. Under the Consumer Protection Law, a business operator providing a commodity or service to a consumer is subject to a number of requirements, including the following:

Table of Contents

- to ensure that commodities and services meet with certain safety requirements;

- to protect the safety of consumers;

- to disclose serious defects of a commodity or a service and to adopt preventive measures against damage occurrence;

- to provide consumers with accurate information and to refrain from conducting false advertising;

- to obtain consents of consumers and to disclose the rules for the collection and/or use of information when collecting data or information from consumers; to take technical measures and other necessary measures to protect the personal information collected from consumers; not to divulge, sell, or illegally provide consumers' information to others; not to send commercial information to consumers without the consent or request of consumers or with a clear refusal from consumers;

- not to set unreasonable or unfair terms for consumers or alleviate or release itself from civil liability for harming the legal rights and interests of consumers by means of standard contracts, circulars, announcements, shop notices or other means;

- to remind consumers in a conspicuous manner to pay attention to the quality, quantity and prices or fees of commodities or services, duration and manner of performance, safety precautions and risk warnings, after-sales service, civil liability and other terms and conditions vital to the interests of consumers under a standard form of agreement prepared by the business operators, and to provide explanations as required by consumers; and

- not to insult or slander consumers or to search the person of, or articles carried by, a consumer or to infringe upon the personal freedom of a consumer.

Business operators may be subject to civil liabilities for failing to fulfill the obligations discussed above. These liabilities include restoring the consumer's reputation, eliminating the adverse effects suffered by the consumer, and offering an apology and compensation for any losses incurred. The following penalties may also be imposed upon business operators for the infraction of these obligations: issuance of a warning, confiscation of any illegal income, imposition of a fine, an order to cease business operation, revocation of its business license or imposition of criminal liabilities under circumstances that are specified in laws and statutory regulations.

In December 2003, the Supreme People's Court in China enacted the Interpretation of *Some Issues Concerning the Application of Law for the Trial of Cases on Compensation for Personal Injury*, which further increases the liabilities of business operators engaged in the operation of hotels, restaurants, or entertainment facilities and subjects such operators to compensatory liabilities for failing to fulfill their statutory obligations to a reasonable extent or to guarantee the personal safety of others.

Regulations on Environmental Protection

In February 2012, the SCNPC issued the newly amended *Law on Promoting Clean Production*, which regulates service enterprises such as restaurants, entertainment establishments and hotels and requires them to use technologies and equipment that conserve energy and water, serve other environmental protection purposes, and reduce or stop the use of consumer goods that waste resources or pollute the environment.

According to the *Environmental Protection Law of the People's Republic of China*, the *Environmental Impact Assessment Law of the People's Republic of China* promulgated by the SCNPC and latest amended on December 29, 2018, the *Regulations Governing Environmental Protection in Construction Projects* promulgated by the State Council on November 29, 1998 and amended July 16, 2017, and the *Regulations Governing Completion Acceptance of Environmental Protection in Construction Projects* promulgated by the Ministry of Environmental Protection on December 27, 2001, hotels shall submit a Report/Form on Environmental Impact Assessment and an Application Letter for Acceptance of Environmental Protection Facilities in Construction Projects to competent environmental protection authorities for approvals before commencing the operation. Pursuant to the *Environmental Impact Assessment Law of the People's Republic of China*, any hotel failing to obtain the approval of the Report/Form of Environmental Impact Assessment may be ordered to cease construction and restore the property to its original state, and according to the violation activities committed and the harmful consequences thereof, be subject to fines of no less than 1% but no more than 5% of the total investment amount for the construction project of such hotel. The person directly responsible for the project may be subject to certain administrative penalties. Pursuant to the *Regulations Governing Completion Acceptance of Environmental Protection in Construction Projects*, any hotel failing to obtain an Acceptance of Environmental Protection Facilities in Construction Projects may be subject to fines and an order to obtain approval within a specified time limit.

Table of Contents

Regulations on Commercial Franchising

Franchise operations are subject to the supervision and administration of the MOC, and its regional counterparts. Such activities are currently regulated by the *Regulations for Administration of Commercial Franchising*, which was promulgated by the State Council on February 6, 2007 and became effective on May 1, 2007. The *Regulations for Administration of Commercial Franchising* were subsequently supplemented by the *Administrative Measures for Archival Filing of Commercial Franchises*, which was newly amended and promulgated by the MOC on December 12, 2011 and became effective on February 1, 2012, and the newly amended *Administrative Measures for Information Disclosure of Commercial Franchises*, which was promulgated by the MOC on February 23, 2012 and became effective on April 1, 2012.

Under the above applicable regulations, a franchisor must have certain prerequisites including a mature business model, the capability to provide long-term business guidance and training services to franchisees and ownership of at least two self-operated storefronts that have been in operation for at least one year within China. Franchisors engaged in franchising activities without satisfying the above requirements may be subject to penalties such as forfeit of illegal income and imposition of fines between RMB100,000 and RMB500,000 and may be bulletined by the MOC or its local counterparts. Franchise contracts shall include certain required provisions, such as terms, termination rights and payments.

Franchisors are generally required to file franchise contracts with the MOC or its local counterparts. Failure to report franchising activities may result in penalties such as fines up to RMB100,000. Such noncompliance may also be bulletined. In the first quarter of every year, franchisors are required to report to the MOC or its local counterparts any franchise contracts they executed, canceled, renewed or amended in the previous year.

The term of a franchise contract shall be no less than three years unless otherwise agreed by franchisees. The franchisee is entitled to terminate the franchise contract in his sole discretion within a set period of time upon signing of the franchise contract.

Pursuant to the *Administrative Measures for Information Disclosure of Commercial Franchises*, 30 days prior to the execution of franchise contracts, franchisors are required to provide franchisees with copies of the franchise contracts, as well as written true and accurate basic information on matters including:

- the name, domiciles, legal representative, registered capital, scope of business and basic information relating to its commercial franchising;

- basic information relating to the registered trademark, logo, patent, know-how and business model;

- the type, amount and method of payment of franchise fees (including payment of deposit and the conditions and method of refund of deposit);

- the price and conditions for the franchisor to provide goods, service and equipment to the franchisee;
- the detailed plan, provision and implementation plan of consistent services including operational guidance, technical support and business training provided to the franchisee;
- detailed measures for guiding and supervising the operation of the franchisor;
- investment budget for all franchised hotels of the franchisee;
- the current numbers, territory and operation evaluation of the franchisees within China;

Table of Contents

- a summary of accounting statements audited by an accounting firm and a summary of audit reports for the previous two years;
- information on any lawsuit in which the franchisor has been involved in the previous five years;
- basic information regarding whether the franchisor and its legal representative have any record of material violation; and
- other information required to be disclosed by the MOC.

In the event of failure to disclose or misrepresentation, the franchisee may terminate the franchise contract and the franchisor may be fined up to RMB100,000. In addition, such noncompliance may be bulletined.

According to the 2008 *Handbook of Market Access of Foreign Investment* promulgated by the MOC in December 2008, if an existing foreign-invested company wishes to operate a franchise in China, it must apply to the MOC or its local counterparts to expand its business scope to include engaging in commercial activities by way of franchise.

Regulations on Trademarks

Both the *PRC Trademark Law* adopted by the SCNPC on August 23, 1982 and revised on August 30, 2013 and the *Implementation Regulation of the PRC Trademark Law* adopted by the State Council on August 3, 2002 and revised on April 29, 2014 give protection to the holders of registered trademarks and trade names. The National Intellectual Property Administration (Trademark Office) handles trademark registrations and grants a term of ten years to registered trademarks. Trademark license agreements must be filed with the Trademark Office.

Regulations on Foreign Currency Exchange

The principal regulations governing foreign currency exchange in China are the *Foreign Exchange Administration Regulations* promulgated by the State Council, as amended on August 5, 2008, or the Foreign Exchange Regulations. Under the Foreign Exchange Regulations, the RMB is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the State Administration of Foreign Exchange, or the SAFE, is obtained and prior registration with the SAFE is made.

On August 29, 2008, the SAFE promulgated the *Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises*, or Circular 142, regulating the conversion by a foreign-invested company of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that the registered capital of a foreign-invested enterprise settled in RMB converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within the PRC. In addition, the SAFE strengthened its oversight of the flow and use of the registered capital of foreign-invested enterprises settled in RMB converted from foreign currencies. The use of such RMB capital may not be changed without the SAFE's approval, and may not in any case be used to repay RMB loans if the proceeds of such loans have not been used. Violations of Circular 142 will result in severe penalties, such as heavy fines.

On March 30, 2015, SAFE issued the *Notice of the State Administration of Foreign Exchange on Reforming the Administrative Approach Regarding the Settlement of the Foreign Exchange Capitals of Foreign-invested Enterprises*, or Circular 19. Circular 19 has superseded Circular 142 by restating certain restrictions on use of registered capital in foreign currency by a foreign-invested company. Nevertheless, Circular 19 specifies that the registered capital of a foreign-invested company in foreign currency can be converted into RMB voluntarily and be allowed to use for equity investment in PRC subject to certain reinvestment registration with local SAFE. However, the interpretation and enforcement of Circular 19 by local SAFE remain significant uncertainties in practice.

On December 25, 2006, the People's Bank of China issued the *Administration Measures on Individual Foreign Exchange Control* and its Implementation Rules were issued by the SAFE on January 5, 2007, both of which became effective on February 1, 2007. Under these regulations, all foreign exchange matters involved in the employee stock ownership plan, stock option plan and other similar plans, participated by onshore individuals shall be transacted upon approval from the SAFE or its authorized branch. On February 25, 2012, the SAFE promulgated the *Notice on Relevant Issues Concerning Foreign Exchange Control on Domestic Individuals Participating in the Stock Incentive Plan of An Overseas Listed Company*, or Circular 7, to replace the *Operating Procedures for Administration of Domestic Individuals Participating in the Employee Stock Option Plan or Stock Option Plan of An Overseas Listed Company*. Under Circular 7, the board members, supervisors, officers or other employees, including PRC citizens and foreigners having lived within the territory of the PRC successively for at least one year of a PRC entity, who participate in stock incentive plans or equity compensation plans by an overseas publicly listed company, or the PRC participants, are required, through a PRC agent or PRC subsidiaries of such overseas publicly-listed company, to complete certain foreign exchange registration procedures with respect to the plans upon the examination by, and approval of, the SAFE. We and our PRC participants who have been granted stock options are subject to Circular 7. If our PRC participants who hold such options or our PRC subsidiary fail to comply with these regulations, such participants and their PRC employer may be subject to fines and legal sanctions.

Table of Contents

Regulations on Share Capital

In October 2005, the SCNPC issued the amended *Company Law of the People's Republic of China*, which became effective on January 1, 2006 and was amended in October 2018. In April 2006, the State Administration for Industry and Commerce, or the SAIC (predecessor of the State Administration for Market Regulation or the SAMR), the MOC, the General Administration of Customs and the SAFE jointly issued the *Implementation Opinions on Several Issues regarding the Laws Applicable to the Administration of Approval and Registration of Foreign-invested Companies*. Pursuant to the above regulations, shareholders of a foreign-invested company are obligated to make full and timely contribution to the registered capital of the foreign-invested company. On June 17, 2014, the MOC issued the *Notice of the Ministry of Commerce on Improving the Administration of Foreign Investment Review*. Pursuant to which, restrictions or requirements on the percentage of initial capital contribution, the percentage of cash contribution and the period of contribution imposed on foreign-invested companies (including companies invested by investors from Taiwan, Hong Kong and Macao regions) are abolished. A company which proposes to reduce its registered capital shall prepare a balance sheet and a list of assets. The company shall notify its creditors within ten days from the date of resolution on reduction of registered capital and publish an announcement on the newspapers within 30 days. The creditors may, within 30 days from receipt of the notice or within 45 days from the announcement date, require the company to settle the debts or provide corresponding guarantee

Regulations on Dividend Distribution

The principal regulations governing distribution of dividends of foreign-invested enterprises include the *Foreign-invested Enterprise Law* promulgated by the SCNPC, as amended on October 31, 2000 and September 3, 2016, respectively, and the *Implementation Rules of the Foreign-invested Enterprise Law* issued by the State Council, as amended on February 19, 2014.

Under these laws and regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign-invested enterprises in China are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

Regulations on Offshore Financing

On October 21, 2005, the SAFE issued *Notice on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles*, or Circular 75, which became effective as of November 1, 2005. Under Circular 75, if PRC residents use assets or equity interests in their PRC entities as capital contributions to establish offshore companies or inject assets or equity interests of their PRC entities into offshore companies to raise capital overseas, they are required to register with local SAFE branches with respect to their overseas investments in offshore companies. PRC residents are also required to file amendments to their registrations if their offshore companies experience material events involving capital variation, such as changes in share capital, share transfers, mergers and acquisitions, spin-off transactions, long-term equity or debt investments or uses of assets in China to guarantee offshore obligations.

Table of Contents

Moreover, Circular 75 applies retroactively. As a result, PRC residents who have established or acquired control of offshore companies that have made onshore investments in the PRC in the past were required to complete the relevant registration procedures with the local SAFE branch by March 31, 2006. Under the relevant rules, failure to comply with the registration procedures set forth in Circular 75 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including the increase of its registered capital, the payment of dividends and other distributions to its offshore parent or affiliate and the capital inflow from the offshore entity, and may also subject relevant PRC residents to penalties under PRC foreign exchange administration regulations. PRC residents who control our company are required to register periodically with the SAFE in connection with their investments in us.

The SAFE issued a series of guidelines to its local branches with respect to the operational process for SAFE registration, including the *Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Administration Policies for Direct Investment*, or Circular 59, which came into effect as of December 17, 2012. The guidelines standardized more specific and stringent supervision on the registration required by Circular 75. For example, the guidelines impose obligations on onshore subsidiaries of an offshore entity to make true and accurate statements to the local SAFE authorities in case any shareholder or beneficial owner of the offshore entity is a PRC citizen or resident. Untrue statements by the onshore subsidiaries will lead to potential liability for the subsidiaries, and in some instances, for their legal representatives and other individuals.

On July 4, 2014, the SAFE issued the *Notice on Issues Relating to the Administration of Foreign Exchange for Overseas Investment and Financing and Reverse Investment by Domestic Residents via Special Purpose Vehicles*, or Circular 37, which became effective and suspended Circular 75 on the same date, and Circular 37 shall prevail over any other inconsistency between itself and relevant regulations promulgated earlier. Pursuant to Circular 37, any PRC residents, including both PRC institutions and individual residents, are required to register with the local SAFE branch before making contribution to a company set up or controlled by the PRC residents outside of the PRC for the purpose of overseas investment or financing with their legally owned domestic or offshore assets or interests, referred to in this circular as a special purpose vehicle. Under Circular 37, the term PRC institutions refers to entities with legal person status or other economic organizations established within the territory of the PRC. The term PRC individual residents includes all PRC citizens (also including PRC citizens abroad) and foreigners who habitually reside in the PRC for economic benefit. A registered special purpose vehicle is required to amend its SAFE registration or file with respect to such vehicle in connection with any change of basic information including PRC individual resident shareholder, name, term of operation, or PRC individual resident's increase or decrease of capital, transfer or exchange of shares, merger, division or other material changes. In addition, if a non-listed special purpose vehicle grants any equity incentives to directors, supervisors or employees of domestic companies under its direct or indirect control, the relevant PRC individual residents could register with the local SAFE branch before exercising such options. The SAFE simultaneously issued a series of guidance to its local branches with respect to the implementation of Circular 37. Under Circular 37, failure to comply with the foreign exchange registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including restrictions on the payment of dividends and other distributions to its offshore parent company and the capital inflow from the offshore entity, and may also subject the relevant PRC residents and onshore company to penalties under the PRC foreign exchange administration regulations. See Risk Factors Risks related to our business PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders to personal liability and limit our ability to inject capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to distribute profits to us, or otherwise adversely affect us.

Regulations on Merger and Acquisition and Overseas Listing

Edgar Filing: Huazhu Group Ltd - Form 20-F

On August 8, 2006, six PRC regulatory agencies, namely the MOC, the State Assets Supervision and Administration Commission, the State Administration of Taxation, the SAIC, the China Securities Regulatory Commission, or the CSRC, and the SAFE, jointly adopted the Regulations on *Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the New M&A Rule, which became effective on September 8, 2006. This New M&A Rule, as amended on June 22, 2009, purports, among other things, to require offshore special purpose vehicles, or SPVs, formed for overseas listing purposes through acquisitions of PRC domestic companies and controlled by PRC companies or individuals, to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange. On September 21, 2006, the CSRC published a notice on its official website specifying documents and materials required to be submitted to it by SPVs seeking the CSRC approval of their overseas listings.

Table of Contents

While the application of this new regulation remains unclear, we believe, based on the advice of our PRC counsel, that CSRC approval is not required in the context of our initial public offering because we established our PRC subsidiaries by means of direct investment other than by merger or acquisition of domestic companies, and we started to operate our business in the PRC through foreign invested enterprises before September 8, 2006, the effective date of the New M&A Rule. However, we cannot assure you that the relevant PRC government agency, including the CSRC, would reach the same conclusion as our PRC counsel. If the CSRC or other PRC regulatory body subsequently determines that CSRC's approval was required for our initial public offering, we may face sanctions by the CSRC or other PRC regulatory agencies, which could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our ADSs.

The New M&A Rule also established additional procedures and requirements that could make merger and acquisition activities by foreign investors more time-consuming and complex, including requirements in some instances that the MOC be notified in advance of any change of control transaction in which a foreign investor takes control of a PRC domestic enterprise.

On July 30, 2017, for the purpose of promoting the reform of the foreign investment administrative system and simplifying the administrative procedures, MOC amended the *Interim Measures for the Record-filing Administration of the Incorporation and Change of Foreign-invested Enterprises* which was promulgated in October 2016. According to the amended interim measures, a record-filing administration system shall apply to foreign investors' mergers and acquisitions of domestic non-foreign-invested enterprises and strategic investments in listed companies, provided that they do not involve the implementation of special access administrative measures prescribed by the state or involve the mergers and acquisitions of affiliates. To be specific, under the record-filing administration system, where a new foreign-invested enterprise is incorporated or a non-foreign invested enterprise changes to a foreign-invested enterprise through acquisition, merger or other means, such incorporation or change no longer requires pre-approval of MOC but should, prior to registration with SAIC or within 30 days after the updated business license issued by SAIC, be filed online on a foreign investment comprehensive administration information system operated by MOC. On June 29, 2018, MOC further amended the interim measures, which provide that such filing shall be completed online together with the registration with SAIC and the relevant department of the State Administration for Market Regulation (SAMR) through the same system.

Regulation on Security Review

In August 2011, the MOC promulgated the *Rules of Ministry of Commerce on Implementation of Security Review System of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the MOC Security Review Rule, which came into effect on September 1, 2011, to implement the *Notice of the General Office of the State Council on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* promulgated on February 3, 2011. Under these regulations, a security review is required for foreign investors' mergers and acquisitions having national defense and security implications and mergers and acquisitions by which foreign investors may acquire de facto control of domestic enterprises having national security implications. In addition, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to a security review, the MOC will look into the substance and actual impact of the transaction. The MOC Security Review Rule further prohibits foreign investors from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions.

Regulations on Labor Contracts

The labor contract law that became effective on January 1, 2008, as amended on December 28, 2012, seeks to clarify the responsibilities of both employers and employees and codifies certain basic rights and protections of employees.

Among others, the labor contract law provides that after completing two fixed-term employment contracts, an employee that desires to continue working for an employer is entitled to require a non-fixed-term employment contract. In addition, employees who have been employed for more than ten years by the same employer are entitled to require a non-fixed-term contract. The labor contract law also requires that the employees dispatched from human resources outsourcing firms or labor agencies be limited to temporary, auxiliary or substitute positions. Furthermore, an employer may be held jointly liable for any damages to its dispatched employees caused by its human resources outsourcing firm or labor agency if it hired such employees through these entities. According to the *Interim Provisions on Labor Dispatch*, which was promulgated in December 2013 to implement the provisions of the labor contract law regarding labor dispatch, a company is permitted to use dispatched employees for up to 10% of its labor force and the companies currently using dispatched employees are given a two-year grace period after March 1, 2014 to comply with this limit.

Table of Contents

Considering the PRC governmental authorities have continued to introduce various new labor-related regulations since the effectiveness of the labor contract law, and the interpretation and implementation of these regulations are still evolving, we cannot assure you that our employment practice will at all times be deemed in compliance with the new regulations. If we are subject to severe penalties or incur significant liabilities in connection with labor disputes or investigations, our business and results of operations may be adversely affected. See Item 3. Key Information D. Risk Factors Risks Related to Our Business Our current employment practices may be adversely impacted under the labor contract law of the PRC.

Regulation on Information Protection on Networks

On December 28, 2012, SCNPC issued *Decision of the Standing Committee of the National People's Congress on Strengthening Information Protection on Networks*, pursuant to which network service providers and other enterprises and institutions shall, when gathering and using electronic personal information of citizens in business activities, publish their collection and use rules and adhere to the principles of legality, rationality and necessarily, explicitly state the purposes, manners and scopes of collecting and using information, and obtain the consent of those from whom information is collected, and shall not collect and use information in violation of laws and regulations and the agreement between both sides; and the network service providers and other enterprises and institutions and their personnel must strictly keep such information confidential and may not divulge, alter, damage, sell, or illegally provide others with such information.

On July 16, 2013, the Ministry of Industry and Information Technology, or the MIIT, issued the *Order for the Protection of Telecommunication and Internet User Personal Information*. The requirements under this order are stricter and wider compared to the above decision issued by the National People's Congress. According to this order, if a network service provider wishes to collect or use personal information, it may do so only if such collection is necessary for the services it provides. Furthermore, it must disclose to its users the purpose, method and scope of any such collection or usage, and must obtain consent from the users whose information is being collected or used. Network service providers are also required to establish and publish their protocols relating to personal information collection or usage, keep any collected information strictly confidential and take technological and other measures to maintain the security of such information. Network service providers are required to cease any collection or usage of the relevant personal information, and de-register the relevant user account, when a user stops using the relevant Internet service. Network service providers are further prohibited from divulging, distorting or destroying any such personal information, or selling or providing such personal information unlawfully to other parties. In addition, if a network service provider appoints an agent to undertake any marketing or technical services that involve the collection or usage of personal information, the network service provider is required to supervise and manage the protection of the information. The order states, in broad terms, that violators may face warnings, fines, public exposure and, in the most severe cases, criminal liability.

On June 1, 2017, the *Cybersecurity Law of the People's Republic of China* promulgated in November, 2016 by SCNPC became effective. This law also absorbed and restated the principles and requirements mentioned in the aforesaid decision and order, and further provides that, where an individual finds any network operator collects or uses his or her personal information in violation of the provisions of any law, regulation or the agreement of both parties, the individual shall be entitled to request the network operator to delete his or her personal information; if the individual finds that his or her personal information collected or stored by the network operator has any error, he or she shall be entitled to request the network operator to make corrections, and the network operator shall take measures to do so. Pursuant to this law, the violators may be subject to: (i) warning; (ii) confiscation of illegal gains and fines equal to 100% to 1000% of the illegal gains; or if without illegal gains, fines up to RMB1,000,000; or (iii) an order to shut down the website, suspend the business operation for rectification, or revoke business license. Besides, responsible persons may be subject to fines between RMB10,000 and RMB100,000.

The Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC GDPR, imposes certain requirements on the processing of personal data relating

to natural persons. GDPR requirements will apply both to companies established in the EU and to companies, such as us, that are not established in the EU but process personal data of individuals who are in the EU (and in the EEA subject to the enactment of implementation procedures), where the processing activities relate to: (a) the offering of goods or services, irrespective of whether a payment of the data subject is required, to such data subjects in the EU; or (b) the monitoring of their behavior as far as their behavior takes place within the EU. The GDPR imposes on concerned companies a large number of obligations, which relate for example, but are not limited, to (i) the principles applying to the processing of personal data: e.g. lawfulness, fairness, transparency, purpose limitation, data minimization and privacy by design, accuracy, storage limitation, security, confidentiality; (ii) the ability of the controller to demonstrate compliance with such principles (accountability); (iii) the obligation to provide information to data subjects in relation to fair processing; (iv) the obligation to identify a legal basis before the processing (special requirements apply to certain specific categories of data such as sensitive data); and (v) data subjects rights (e.g. transparency, right of access, right to rectification, right to erasure, right to restrict processing, right to data portability, right to object to a processing). This leads to companies being under the obligation to implement a number of formal processes and policies reviewing and documenting the privacy implications of the development, acquisition, or use of all new products and services, technologies, or types of data. The GDPR provides for substantial fines for breaches of data protection requirements, which, depending on the infringed provisions of the GDPR, can go up to either: (i) 2% of the annual worldwide turnover of the preceding financial year or EUR10 million, whichever is greater, or (ii) 4% of the annual worldwide turnover of the preceding financial year or EUR20 million, whichever is greater. The fine may be imposed instead of, or in addition to, measures that may be ordered by supervisory authorities (e.g. request to cease the processing). The GDPR and EU Member States law also provide for private enforcement mechanisms and, in the most severe cases, criminal liability.

Table of Contents

The Directive (EC) 2002/58 of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector imposes requirement to obtain informed consent for storage or access to information stored on a user's terminal equipment in the EU. The forthcoming Regulation on privacy and electronic communications, aiming at repealing the Directive 2002/58, will update the current rules applicable to companies storing cookies on users' terminal equipments and using online tracking. Sanctions may be imposed on companies not fully compliant with all practices in relation to the implementation of the regulation on e-privacy.

4.C. Organizational Structure

The following diagram illustrates our corporate and ownership structure, the place of formation and the ownership interests of our subsidiaries as of March 31, 2019.

Table of Contents

Table of Contents

The following table sets forth summary information for our significant subsidiaries as of March 31, 2019.

Major Subsidiaries	Percentage of Ownership	Date of Incorporation/Acquisition	Place of Incorporation
China Lodging Holdings (HK) Limited	100%	October 22, 2008	Hong Kong
China Lodging Holdings Singapore Pte. Ltd.	100%	April 14, 2010	Singapore
Shanghai HanTing Hotel Management Group, Ltd.1	100%	November 17, 2004	PRC
HanTing Xingkong (Shanghai) Hotel Management Co., Ltd.1	100%	March 3, 2006	PRC
HanTing (Tianjin) Investment Consulting Co., Ltd	100%	January 16, 2008	PRC
Yiju (Shanghai) Hotel Management Co., Ltd.1	100%	April 12, 2007	PRC
HanTing Technology (Suzhou) Co., Ltd.	100%	December 3, 2008	PRC
HanTing (Shanghai) Enterprise Management Co., Ltd.	100%	December 14, 2010	PRC
Starway Hotels (Hong Kong) Limited	100%	May 1, 2012	Hong Kong
Starway Hotel Management (Shanghai) Co., Ltd.	100%	May 1, 2012	PRC
HuaZhu Hotel Management Co., Ltd.2	100%	August 16, 2012	PRC
Jizhu Information Technology (Shanghai) Co., Ltd.3	100%	February 26, 2014	PRC
H-World Information and Technology Co., Ltd.	84.1%	November 7, 2013	PRC
ACL Greater China Limited	100%	May 9, 2016	Hong Kong
Ibis China Investment Limited	100%	April 22, 2016	Hong Kong
TAHM Investment Limited	100%	August 4, 2016	Hong Kong
Huazhu Investment I Limited	100%	November 10, 2017	Hong Kong
Yagao Meihua Hotel Management Co., Ltd.	100%	February 16, 2015	PRC
Crystal Orange Hotel Holdings Limited	100%	May 25, 2017	BVI
Orange Hotel Hong Kong Limited	100%	May 25, 2017	Hong Kong
Orange Hotel Management (China) Co., Ltd.	100%	May 25, 2017	PRC
Beijing Crystal Orange Hotel Management Consulting Co., Ltd.	100%	May 25, 2017	PRC
Blossom Hill Hotel Investment Management (Kunshan) Co., Ltd.	94%	August 31, 2018	PRC
Huazhu Hotel Management (Ningbo) Co., Ltd.	100%	July 20, 2018	PRC

Table of Contents

4.D. Property, Plants and Equipment

Our headquarters are located in Shanghai, China and occupy nearly 13,400 square meters of office space, about 1,500 square meters of which is owned by us and the rest is leased. As of December 31, 2018, we leased 692 out of our 4,230 hotel facilities with an aggregate size of approximately 3.7 million square meters, including approximately 102,400 square meters subleased to third parties. As of December 31, 2018, we owned seven out of our 4,230 hotel facilities with an aggregate size of approximately 53,900 square meters, of which less than 800 square meters subleased to third parties. For detailed information about the locations of our hotels, see Item 4. Information on the Company B. Business Overview Our Hotel Network.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

5.A. Operating Results

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Item 3. Key Information D. Risk Factors or in other parts of this annual report on Form 20-F.

Overview

We are a leading and fast-growing multi-brand hotel group in China with leased and owned, manachised and franchised models. Under the lease and ownership model, we directly operate hotels located primarily on leased properties. Under the manachise model, we manage manachised hotels through the on-site hotel managers we appoint and collect fees from franchisees. Under the franchise model, we provide training, reservation and support services to the franchised hotels and collect fees from franchisees but do not appoint on-site hotel managers. We apply a consistent standard and platform across all of our hotels. As of December 31, 2018, we had 699 leased and owned, 3,309 manachised and 222 franchised hotels in operation and 42 leased and owned hotels and 1,063 manachised and franchised hotels under development.

As of the date of this annual report, we own 12 hotel brands that are designed to target distinct segments of customers:

- *Hi Inn*, our budget hotel product which targets practical and price-conscious travelers, originally marketed under the name of *HanTing Hi Inn*;
- *HanTing Hotel*, our economy hotel product which targets knowledge workers and value- and quality-conscious travelers, originally marketed under the name of *HanTing Express Hotel*;
- *Elan Hotel*, our economy hotel product which targets business travelers, young customers and urban tourists. *Elan Hotel* is committed to provide a unique business and travel life experience for its guests;
- *Orange Hotel*, our economy brand, features three-star standard facilities at affordable prices;
- *HanTing Premium*, our entry level midscale hotel brand targeting middle class leisure travelers and midscale corporate events;

Table of Contents

- *Starway Hotel*, our midscale limited service hotel product with variety in design and consistency in quality which targets middle class travelers who seek a spacious room, reasonable price and guaranteed quality;
- *Ji Hotel*, our standardized midscale limited service hotel product which targets mature and experienced travelers who seek a quality experience in hotel stays, previously marketed first under the name of *HanTing Hotel* and then *HanTing Seasons Hotel*;
- *Orange Hotel Select*, our midscale hotel brand, is the mini version of our *Crystal Orange Hotel*;
- *Manxin Hotel*, our mid-to-upscale hospitality brand including city hotels and resorts. *Manxin Hotel* targets business travelers, leisure travelers, families and corporate events;
- *Crystal Orange Hotel*, our mid-to-upscale hotel brand, features boutique design hotels equipped with advanced, five-star standard facilities; and
- *Joya Hotel*, our upscale brand concept targeting affluent travelers and corporate events. Joya hotels are typically located in central business districts.
- *Blossom Hill Hotels and Resorts*, our upscale lifestyle and resort brand targeting affluent travelers. Most of Blossom Hill's hotels are located in typical scenic spots.

In addition to the 12 hotel brands owned by us, we entered into brand franchise agreements with Accor and enjoyed exclusive franchise rights in respect of *Mercure*, *Ibis* and *Ibis Styles* in the PRC, Taiwan and Mongolia and non-exclusive franchise rights in respect of *Grand Mercure* and *Novotel* in the PRC, Taiwan and Mongolia:

- *Ibis*, an economy hotel brand that is recognized across the world for its quality, reliability and commitment to the environment.
- *Ibis Styles*, a midscale brand that offers comfortable, designer hotels at an all-inclusive rate;

- *Mercure*, a midscale hotel brand that targets business and leisure travelers around the world;
- *Novotel*, a mid-to-upscale brand that provides a multi-service offer for both business and leisure guests; and
- *Grand Mercure*, a brand that offers a upscale network of hotels and apartments that combine local culture with world-class services;

As a result of our customer-oriented approach, we have developed strong brand recognition and a loyal customer base. In 2018, approximately 76% of our room nights were sold to members of HUAZHU Rewards, our loyalty program.

Our operations commenced with midscale limited service hotels and commercial property development and management in 2005. We began our current business of operating and managing a multi-brand hotel group in 2007. Our net revenues grew from RMB6,573 million in 2016 to RMB8,229 million in 2017 and further to RMB10,063 million (US\$1,464 million) in 2018. We had net income attributable to our company of RMB782 million, RMB1,228 million and RMB716 million (US\$104 million) in 2016, 2017 and 2018, respectively. We had net cash provided by operating activities of RMB2,066 million, RMB2,453 million and RMB3,049 million (US\$444 million) in 2016, 2017 and 2018, respectively.

Specific factors affecting our results of operations

While our business is affected by factors relating to general economic conditions and the lodging industry in China (see Item 3. Key Information D. Risk Factors Risks Related to Our Business Our operating results are subject to conditions affecting the lodging industry in general.), we believe that our results of operations are also affected by company-specific factors, including, among others:

- *The total number of hotels and hotel rooms in our hotel network.* Our revenues largely depend on the size of our hotel network. Furthermore, we believe the expanded geographic coverage of our hotel network will enhance our brand recognition. Whether we can successfully increase the number of hotels and hotel rooms in our hotel group is largely affected by our ability to effectively identify and lease, own, manachise or franchise additional hotel properties at desirable locations on commercially favorable terms and the availability of funding to make necessary capital investments to open these new hotels.

Table of Contents

- *The fixed-cost nature of our business.* A significant portion of our operating costs and expenses, including rent and depreciation and amortization, is relatively fixed. As a result, an increase in our revenues achieved through higher RevPAR generally will result in higher profitability. Vice versa, a decrease in our revenues could result in a disproportionately larger decrease in our earnings because our operating costs and expenses are unlikely to decrease proportionately.
- *The number of new leased and owned hotels under development.* Generally, the operation of each leased and owned hotel goes through three stages: development, ramp-up and mature operations. During the development stage, leased and owned hotels generally incur pre-opening expenses ranging from approximately RMB2.0 million to RMB20.0 million per hotel and generate no revenue. During periods when a large number of new leased and owned hotels are under development, the pre-opening expenses incurred may have a significant negative impact on our financial performance.
- *The mix of mature leased and owned hotels, new leased and owned hotels, manachised hotels and franchised hotels.* When a new hotel starts operation and goes through the ramp-up stage, the occupancy rate is relatively low and the room rate may be subject to discount. Revenues generated by these hotels are lower than those generated by mature hotels and may be insufficient to cover their operating costs, which are relatively fixed in nature and are similar to those of mature hotels. The lower profitability during the ramp-up stage for leased and owned hotels may have a significant negative impact on our financial performance. The length of ramp-up stage may be affected by factors such as hotel size, seasonality and location. New hotels opened in lower-tier cities generally have longer ramp-up period. On average, it takes our hotels approximately six months to ramp up. We define mature leased and owned hotels as those that have been in operation for more than six months. Our mature leased and owned hotels have been and will continue to be the main contributor to our revenues.

Under the manachise and franchise models, we generate revenues from fees we charge to each manachised and franchised hotel while the franchisee bears substantially all the capital expenditures, pre-opening and operational expenses. The hotel operating costs relating to manachised hotels are mainly costs for hotel managers as we hire and send them to manachised hotels.

Key Performance Indicators

We utilize a set of non-financial and financial key performance indicators which our senior management reviews frequently. The review of these indicators facilitates timely evaluation of the performance of our business and effective communication of results and key decisions, allowing our business to react promptly to changing customer demands and market conditions.

Non-financial Key Performance Indicators

Edgar Filing: Huazhu Group Ltd - Form 20-F

Our non-financial key performance indicators consist of (i) change in the total number of hotels and hotel rooms in our hotel group, (ii) RevPAR, especially RevPAR achieved by our leased and owned hotels and (iii) same-hotel RevPAR change.

Change in the total number of hotels and hotel rooms. We track the change in the total number of hotels and hotel rooms in operation to monitor our business expansion. Our total hotels in operation increased from 3,269 as of December 31, 2016 to 4,230 as of December 31, 2018 and our total hotel room-nights available for sale increased from 112.9 million as of December 31, 2016 to 144.5 million as of December 31, 2018. The following table sets forth various measures of changes in the total number of hotels and hotel rooms as of and for the dates and periods indicated.

	2016	As of December 31, 2017	2018
Total hotels in operation	3,269	3,746	4,230
Leased and owned hotels	624	671	699
Manachised hotels	2,471	2,874	3,309
Franchised hotels	174	201	222
Total hotel rooms in operation	331,347	379,675	422,747
Leased and owned hotels	78,160	85,018	86,787
Manachised hotels	237,094	275,065	314,932
Franchised hotels	16,093	19,592	21,028
Total hotel room-nights available for sale	112,937,662	128,761,738	144,497,182
Leased and owned hotels	28,346,421	30,198,307	31,448,206
Manachised hotels	80,161,362	92,582,541	105,917,757
Franchised hotels	4,429,879	5,980,890	7,131,219
Number of cities	367	378	403

Table of Contents

RevPAR. RevPAR is a commonly used operating measure in the lodging industry and is defined as the product of average occupancy rates and average daily rates achieved. Occupancy rates of our hotels mainly depend on the locations of our hotels, product and service offering, the effectiveness of our sales and brand promotion efforts, our ability to effectively manage hotel reservations, the performance of managerial and other employees of our hotels, as well as our ability to respond to competitive pressure. From year to year, occupancy of our portfolio may fluctuate as a result of change in the mix of mature and ramp-up hotels, as well as special event such as the Shanghai Expo in 2010. We set the room rates of our hotels primarily based on the location of a hotel, room rates charged by our competitors within the same locality, and our relative brand and product strength in the city or city cluster. From year to year, average daily rate of our portfolio may change due to our yield management practice, city mix change and special events such as Shanghai Expo in 2010. The following table sets forth our RevPAR, average daily room rate and occupancy rate for our leased and owned and manachised hotels for the periods indicated.

	Year Ended December 31,		
	2016	2017	2018
RevPAR (1) (in RMB)			
Leased and owned hotels	179	211	237
Manachised hotels	151	171	186
Franchised hotels	125	158	188
Total hotels in operation	157	180	197
Average daily room rate (1) (in RMB)			
Leased and owned hotels	208	237	267
Manachised hotels	177	191	213
Franchised hotels	182	216	248
Total hotels in operation	185	203	226
Occupancy rate (as a percentage)			
Leased and owned hotels	86	89	89
Manachised hotels	85	89	88
Franchised hotels	69	73	76
Total hotels in operation	85	88	87
Weight of hotel room-nights available for sale contributed by leased and owned hotels less than 6 months (as a percentage)	3	8	4

(1) Value-added tax has been implemented for hospitality industry to replace business tax in China effective May 1, 2016. Our room rates quoted and received from customers are tax-inclusive (business tax or value-added tax) before and after the implementation of value-added tax. For comparison purposes, the RevPAR and average daily room rates disclosed in this annual report are based on the tax-inclusive room rates.

RevPAR may change from period to period due to (i) the change in the mix of our leased and owned hotels in the ramp-up and mature phases, (ii) the change in the mix of our hotels in different cities and locations, (iii) the change in the mix of our hotels of different brands, and (iv) the change in same-hotel RevPAR. The total hotel RevPAR in 2018 is higher than that in 2017, and the total hotel RevPAR in 2017 is higher than that in 2016, mainly as a result of upgrade of Hanting 2.0 and the growing demand of our midscale hotels.

Table of Contents

The seasonality of our business may cause fluctuations in our quarterly RevPAR. We typically have the lowest RevPAR in the first quarter due to reduced travel activities in the winter and during the Spring Festival holidays, and the highest RevPAR in the third quarter due to increased travel during the summer. National and regional special events that attract large numbers of people to travel may also cause fluctuations in our RevPAR.

	March 31, 2017	June 30, 2017	September 30, 2017	For the Three Months Ended				
				December 31, 2017	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
RevPAR (in RMB):								
Leased and owned hotels	174	211	238	219	208	246	257	238
Manachised hotels	147	171	192	170	163	190	205	185
Franchised hotels	118	151	186	167	159	195	213	185
Total hotels in operation	152	179	203	181	173	203	217	196

Same-hotel RevPAR change. Our overall RevPAR trend does not reflect the trend of a stable and mature portfolio, because it may fluctuate when city mix and mix of mature and ramp-up hotels change. We track same-hotel year-over-year RevPAR change for hotels in operation for at least 18 months to monitor RevPAR trend for our mature hotels on a comparable basis. The following table sets forth our same-hotel RevPAR for hotels in operation for at least 18 months for the periods indicated.

	March 31, 2017	June 30, 2017	September 30, 2017	For the Three Months Ended				
				December 31, 2017	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Number of hotels in operation for at least 18 months	2,380	2,513	2,603	2,729	2,813	2,866	2,908	2,980
RevPAR (RMB)	151	175	193	172	165	194	207	189
Same-hotel RevPAR change (as a percentage)	6	8	10	6	6.5	7.9	4.2	3.9

Financial Key Performance Indicators

Our financial key performance indicators consist of (i) revenues, (ii) operating costs and expenses, (iii) EBITDA and Adjusted EBITDA, and (iv) net cash provided by operating activities.

Revenues. We primarily derive our revenues from operations of our leased and owned hotels and franchise and service fees from our manachised and franchised hotels. Our revenues are subject to business tax of 5% (before May 1, 2016) and other related taxes. The following table sets forth the revenues generated by our leased and owned and manachised and franchised hotels and other revenues, each in absolute amount and as a percentage of total revenues

for the periods indicated.

	2016		Year Ended December 31, 2017			2018	
	(RMB)	%	(RMB)	%	(RMB)	(US\$)	%
(In millions except percentages)							
Revenues:							
Leased and owned hotels	5,239	78.3	6,338	77.0	7,470	1,087	74.2
Manachised and franchised hotels	1,419	21.2	1,851	22.5	2,527	368	25.1
Others	31	0.5	40	0.5	66	9	0.7
Total revenues	6,689	100.0	8,229	100.0	10,063	1,464	100.0
Less: Business tax and related taxes(1)	116	1.7					
Net revenues	6,573	98.3	8,229	100.0	10,063	1,464	100.0

Table of Contents

(1) Value-added tax has been implemented for hospitality industry to replace business tax in China effective May 1, 2016.

- *Leased and Owned Hotels.* In 2016, we generated revenue of RMB5,239 million from our leased and owned hotels, which accounted for 78.3% of our total revenues for the year. In 2017, we generated revenue of RMB6,338 million from our leased and owned hotels, which accounted for 77.0% of our total revenues for the year. In 2018, we generated revenues of RMB7,470 million (US\$1,087 million) from our leased and owned hotels, which amounted for 74.2% of our total revenues for the year. We expect that revenues from our leased and owned hotels will continue to constitute a substantial majority of our total revenues in the foreseeable future. As of December 31, 2018, we had 42 leased and owned hotels under development.

For our leased hotels, we lease properties from real estate owners or lessors and we are responsible for hotel development and customization to conform to our standards, as well as for repairs and maintenance and operating costs and expenses of properties over the term of the lease. We are also responsible for substantially all aspects of hotel operations and management, including hiring, training and supervising the hotel managers and employees required to operate our hotels and purchasing supplies. Our typical lease term ranges from ten to 20 years. We typically enjoy an initial two- to six-month rent-free period. We generally pay fixed rent on a quarterly or biannual basis for the first three to five years of the lease term, after which we are generally subject to a 3% to 5% increase every three to five years.

Our owned hotels include the hotels we acquired as part of our strategic alliance with Accor in 2016, and the ones we acquired through acquisition of Blossom Hill in 2018.

Our revenues generated from leased and owned hotels are significantly affected by the following two operating measures:

- *The total number of room nights available from the leased and owned hotels in our hotel group.* The future growth of revenues generated from our leased and owned hotels will depend significantly upon our ability to expand our hotel group into new locations in China and maintain and further increase our RevPAR at existing hotels. As of December 31, 2018, we had 42 properties for our leased and owned hotels, which are currently under development.

- *RevPAR achieved by our leased and owned hotels, which represents the product of average daily rates and occupancy rates.* To understand factors impacting our RevPAR, please see Non-financial Key Performance Indicators RevPAR.

- *Manachised and Franchised Hotels.* In 2016, we generated revenues of RMB1,419 million from our manachised and franchised hotels, which accounted for 21.2% of our total revenues for the year. In 2017, we generated revenues of RMB1,851 million from our manachised and franchised hotels, which accounted for 22.5% of our total revenues for the year. In 2018, we generated revenues of RMB2,527 million (US\$368 million) from our

manachised and franchised hotels, which accounted for 25.1% of our total revenues for the year. We expect that revenues from our manachised and franchised hotels will increase in the foreseeable future as we add more manachised and franchised hotels in our hotel group. We also expect the number of our manachised and franchised hotels as a percentage of the total number of hotels in our network to increase. As of December 31, 2018, we had 1,063 manachised and franchised hotels under development.

- *Manachised Hotels.* Our franchisees either lease or own their hotel properties and also invest in the renovation of their properties according to our product standards. Our franchisees are typically responsible for the costs of developing and operating the hotels, including renovating the hotels according to our standards, and all of the operating expenses. We directly manage our manachised hotels and impose the same standards for all manachised hotels to ensure product quality and consistency across our hotel network. Management services we provide to our franchisees for our manachised hotels generally include hiring, appointing and training hotel managers, managing reservations, providing sales and marketing support, conducting quality inspections and providing other operational support and information. We believe our manachise model has enabled us to quickly and effectively expand our geographical coverage and market share in a less capital-intensive manner through leveraging the local knowledge and relationships of our franchisees.

Table of Contents

We collect fees from our franchisees and do not bear the loss, if any, incurred by our franchisees. They are also responsible for all costs and expenses related to hotel construction and refurbishing. Our franchise and management agreements for manachised hotels typically run for an initial term of eight to ten years. Our franchisees are generally required to pay us a one-time franchise fee ranging between RMB80,000 and RMB500,000. In general, we charge a monthly franchise fee of approximately 5% to 6.5% of the total revenues generated by each manachised hotel. We also collect from franchisees a reservation fee for using our central reservation system and a membership registration fee to service customers who join our HUAZHU Rewards loyalty program at the manachised hotels. Furthermore, we employ and appoint hotel managers for the manachised hotels and charge the franchisees a monthly fee for such service.

- **Franchised Hotels.** Under our typical franchise agreements, we provide our franchisees with training, central reservation, sales and marketing support, quality assurance inspections and other operational support and information services. We do not appoint hotel managers for our franchised hotels. We collect fees from the franchisees of our franchised hotels and do not bear any loss or share any profit incurred or realized by our franchisees.
- **Other Revenues.** Other revenues of RMB31 million, RMB40 million and RMB66 million (US\$9 million) in 2016, 2017 and 2018, respectively, represent revenues generated from other than the operation of hotel businesses, which mainly include revenues from the provision of IT products and services to hotels and revenues from Hua Zhu mall.

Operating Costs and Expenses. Our operating costs and expenses consist of costs for hotel operation, other operating cost, selling and marketing expenses, general and administrative expenses and pre-opening expenses. The following table sets forth the components of our operating costs and expenses, both in absolute amount and as a percentage of net revenues for the periods indicated.

	2016		Year Ended December 31, 2017		2018		
	(RMB)	%	(RMB)	%	(RMB)	(US\$)	%
Net revenues	6,573	100.0	8,229	100.0	10,063	1,464	100.0
Operating costs and expenses							
Hotel operating costs:							
Rents	1,871	28.5	2,059	25.0	2,406	350	23.9
Utilities	346	5.3	366	4.4	399	58	4.0
Personnel costs	1,089	16.6	1,388	16.9	1,663	242	16.5
Depreciation and amortization	677	10.3	773	9.4	869	126	8.6
Consumables, food and beverage	495	7.5	551	6.7	673	98	6.7
Others	456	6.9	538	6.6	466	68	4.7
Total hotel operating costs	4,934	75.1	5,675	69.0	6,476	942	64.4
Other operating costs	8	0.1	17	0.2	15	2	0.1
Selling and marketing	209	3.2	285	3.5	348	50	3.5

Edgar Filing: Huazhu Group Ltd - Form 20-F

expenses							
General and administrative expenses	492	7.5	691	8.4	851	124	8.5
Pre-opening expenses	72	1.1	206	2.5	255	37	2.5
Total operating costs and expenses	5,715	87.0	6,874	83.6	7,945	1,155	79.0

Edgar Filing: Huazhu Group Ltd - Form 20-F

Total pre-opening expenses	72	206	255	37
----------------------------	----	-----	-----	----

Our hotel operating costs, selling and marketing expenses and general and administrative expenses include share-based compensation expenses. The following table sets forth the allocation of our share-based compensation expenses, both in absolute amount and as a percentage of total share-based compensation expenses, among the cost and expense items set forth below.

Table of Contents

	2016		Year Ended December 31, 2017			2018	
	(RMB)	%	(RMB)	%	(RMB)	(US\$)	%
	(In millions except percentages)						
Hotel operating costs	13	24.5	20	29.7	27	4	32.8
Selling and marketing expenses	1	1.5	1	2.3	3	0	3.1
General and administrative expenses	41	74.0	45	68.0	53	8	64.1
Total share-based compensation expenses	55	100.0	66	100.0	83	12	100.0

We adopted our 2007 Global Share Plan and 2008 Global Share Plan in February and June 2007, respectively, expanded the 2008 Global Share Plan in October 2008, adopted the 2009 Share Incentive Plan in September 2009, and expanded the 2009 Share Incentive Plan in October 2009, August 2010 and March 2015. We did not grant any options to purchase our ordinary shares in 2016, 2017 and 2018. We granted 1,919,791, 493,972 and 1,708,980 shares of restricted stock in 2016, 2017 and 2018, respectively. We recognized share-based compensation as compensation expenses in the statement of comprehensive income based on the fair value of equity awards on the date of the grant, with the compensation expenses recognized over the period in which the recipient is required to provide service to us in exchange for the equity award. Share-based compensation expenses have been categorized as hotel operating costs, general and administrative expenses, or selling and marketing expenses, depending on the job functions of the grantees.

EBITDA and Adjusted EBITDA. We use earnings before interest income, interest expense, income tax expense (benefit) and depreciation and amortization, or EBITDA, a non-GAAP financial measure, to assess our results of operations before the impact of investing and financing transactions and income taxes. Given the significant investments that we have made in leasehold improvements, depreciation and amortization expense comprises a significant portion of our cost structure. We believe that EBITDA is widely used by other companies in the lodging industry and may be used by investors as a measure of our financial performance. We also use Adjusted EBITDA, another non-GAAP measure, which is defined as EBITDA before share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities. We present Adjusted EBITDA because it is used by our management to evaluate our operating performance. We also believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our consolidated results of operations in the same manner as our management and in comparing financial results across accounting periods and to those of our peer companies.

The following tables present certain unaudited financial data and selected operating data for the years ended December 31, 2016, 2017 and 2018:

	Year Ended December 31,		2018
	2016 (RMB)	2017 (RMB)	
	(In millions)		

Non-GAAP Financial Data				
EBITDA(1)	1,700	2,348	2,272	331
Adjusted EBITDA (1)	1,755	2,379	3,269	476

(1) We believe that EBITDA is a useful financial metric to assess our operating and financial performance before the impact of investing and financing transactions and income taxes. Given the significant investments that we have made in leasehold improvements, depreciation and amortization expense comprises a significant portion of our cost structure. In addition, we believe that EBITDA is widely used by other companies in the lodging industry and may be used by investors as a measure of our financial performance. We believe that EBITDA will provide investors with a useful tool for comparability between periods because it eliminates depreciation and amortization expense attributable to capital expenditures. We also use Adjusted EBITDA, which is defined as EBITDA before share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities. We present Adjusted EBITDA because it is used by our management to evaluate our operating performance. We also believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our consolidated results of operations in the same manner as our management and in comparing financial results across accounting periods and to those of our peer companies. Our calculation of EBITDA and Adjusted EBITDA does not deduct foreign exchange gain, which was RMB16 million in 2016, foreign exchange loss, which was RMB18 million in 2017, and foreign exchange loss, which was RMB144 million (US\$21 million) in 2018. The presentation of EBITDA and Adjusted EBITDA should not be construed as an indication that our future results will be unaffected by other charges and gains we consider to be outside the ordinary course of our business.

Table of Contents

The use of EBITDA and Adjusted EBITDA has certain limitations. Depreciation and amortization expense for various long-term assets, income tax, interest income and interest expense have been and will be incurred and are not reflected in the presentation of EBITDA. Share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities have been and will be incurred and are not reflected in the presentation of Adjusted EBITDA. Each of these items should also be considered in the overall evaluation of our results. Additionally, EBITDA or Adjusted EBITDA does not consider capital expenditures and other investing activities and should not be considered as a measure of our liquidity. We compensate for these limitations by providing the relevant disclosure of our depreciation and amortization, interest income, interest expense, income tax expense, share-based compensation expenses, unrealized gains (losses) from fair value changes of equity securities, capital expenditures and other relevant items both in our reconciliations to the U.S. GAAP financial measures and in our consolidated financial statements, all of which should be considered when evaluating our performance.

The terms EBITDA and Adjusted EBITDA are not defined under U.S. GAAP, and neither EBITDA nor Adjusted EBITDA is a measure of net income, operating income, operating performance or liquidity presented in accordance with U.S. GAAP. When assessing our operating and financial performance, you should not consider this data in isolation or as a substitute for our net income, operating income or any other operating performance measure that is calculated in accordance with U.S. GAAP. In addition, our EBITDA or Adjusted EBITDA may not be comparable to EBITDA or Adjusted EBITDA or similarly titled measures utilized by other companies since such other companies may not calculate EBITDA or Adjusted EBITDA in the same manner as we do.

A reconciliation of EBITDA and Adjusted EBITDA to net income, which is the most directly comparable U.S. GAAP measure, is provided below:

	For the Year Ended December 31,			
	2016 (RMB)	2017 (RMB)	2018 (RMB)	2018 (US\$)
	(In millions)			
Net income attributable to our company	782	1,228	716	104
Interest income	(67)	(113)	(148)	(21)
Interest expense	11	87	244	35
Income tax expense	279	357	569	83
Depreciation and amortization	695	789	891	130
EBITDA (Non-GAAP)	1,700	2,348	2,272	331
Share-based compensation expenses	55	66	83	12
Unrealized (gains) losses from fair value changes of equity securities		(35)	914	133
Adjusted EBITDA (Non-GAAP)	1,755	2,379	3,269	476

Net Cash Provided by Operating Activities. Our net cash provided by operating activities is primarily attributable to our net income, add-backs from share-based compensation expenses, depreciation and amortization, impairment loss, deferred rent, investment loss (income) and changes in operating assets and liabilities. We use net cash provided by operating activities to assess the cash generation capability and return profile of our business. Compared with adjusted EBITDA, net cash provided by operating activities neutralizes the impact of straight-line based rental accounting and timing difference in certain areas of revenue recognition when assessing the return profile and profitability of our business. We had net cash provided by operating activities of RMB2,066 million, RMB2,453 million and RMB3,049 million (US\$444 million) in 2016, 2017 and 2018, respectively. The year-over-year increase was mainly due to the expansion of our hotel network. We expect that our net cash provided by operating activities will continue to increase as we

further expand our hotel network.

Table of Contents

Taxation

We are incorporated in the Cayman Islands. Under the current law of the Cayman Islands, Huazhu, China Lodging Investment Limited, CLG Special Investments Limited and City Home Group Limited are not subject to income or capital gains tax. In addition, dividend payments we make are not subject to withholding tax in the Cayman Islands.

China Lodging HK, Starway HK, IBIS China Investment Limited, ACL Greater China Limited, Orange Hotel Hong Kong Limited, TAHM Investment Limited, City Home Investment Limited, Huazhu Investment I Limited and Huazhu Investment II Limited are subject to a profit tax at the rate of 16.5% on assessable profit determined under relevant Hong Kong tax regulations.

China Lodging Singapore is subject to Singapore corporate income tax at a rate of 17%. No Singapore profit tax has been provided as we have not had assessable profit that was earned in or derived from Singapore during the years presented.

Under the current tax laws of the British Virgin Islands, Crystal Orange Hotel Holdings Limited is not subject to tax on income or capital gain.

Under the current tax laws of Seychelles, Sheen Step Group Limited is not subject to tax on income or capital gain.

On March 16, 2007, the National People's Congress passed the Enterprise Income Tax Law, which was most recently amended in December 2018, and on December 6, 2007, the PRC State Council issued the *Implementation Regulations of the Enterprise Income Tax Law*, both of which became effective on January 1, 2008. The Enterprise Income Tax Law and its Implementation Regulations, or the EIT Law, applies a uniform 25% enterprise income tax rate to both foreign-invested enterprises and domestic enterprises.

The EIT Law imposes a withholding tax of 10% on dividends distributed by a PRC foreign-invested enterprise to its immediate holding company outside of China, if such immediate holding company is considered a non-resident enterprise without any establishment or place within China or if the received dividends have no connection with the establishment or place of such immediate holding company within China, unless such immediate holding company's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding tax rate. A holding company which is a tax resident in Hong Kong, for example, would be subject to a 5% withholding tax rate on the dividends received from its PRC subsidiary if it owns at least 25% equity in the PRC subsidiary and is the beneficial owner of the dividends. See Item 3. Key Information D. Risk Factors Risks Related to Doing Business in China. It is unclear whether we will be considered as a PRC resident enterprise under the EIT Law, and depending on the determination of our PRC resident enterprise status, if we are treated as a non-resident enterprise of the PRC, dividends paid to us by our PRC subsidiaries will be subject to PRC withholding tax; if we are treated as a PRC resident enterprise, we may be subject to 25% PRC income tax on our worldwide income, and holders of our ADSs or ordinary shares that are non-PRC resident investors may be subject to PRC withholding tax on dividends paid by us and gains realized on their transfer of our ADSs or ordinary shares.

Critical Accounting Policies

Edgar Filing: Huazhu Group Ltd - Form 20-F

We prepare financial statements in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect the reported amounts of our assets and liabilities and the disclosure of our contingent assets and liabilities at the end of each fiscal period and the reported amounts of revenues and expenses during each fiscal period. We continue to evaluate these judgments and estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and assumptions that we believe to be reasonable, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

Table of Contents

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors that should be considered when reviewing our financial statements. We believe the following accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition

Revenue are primarily derived from products and services in leased and owned hotels, contracts of manachised and franchised hotels with third-party franchisees as well as activities other than the operation of hotel businesses.

Leased and owned hotel revenues

Leased and owned hotel revenues are primarily derived from the rental of rooms, food and beverage sales and other ancillary goods and services, including but not limited to souvenir, laundry, parking and conference reservation. Each of these products and services represents an individual performance obligation and, in exchange for these services, we receive fixed amounts based on published rates or negotiated contracts. Payment is due in full at the time when the services are rendered or the goods are provided. Room rental revenue is recognized on a daily basis when rooms are occupied. Food and beverage revenue and other goods and services revenue are recognized when they have been delivered or rendered to the guests as the respective performance obligations are satisfied.

Manachised and franchised hotel revenues

The manachised and franchised agreement contains the following promised services:

- *Intellectual Property (IP) license* grant the right to access our hotel system IP, including brand names.
- *Pre-opening services* include providing services (e.g., install IT information system and provide access to purchase platform, help to obtain operational qualification, and help to recruit and train employees) to the franchisees to assist in preparing for the hotel opening.
- *System maintenance services* include providing standardization hotel property management system (PMS), central reservation system (CRS) and other internet related services.

- *Hotel management services* include providing day-to-day management services of the hotels for the franchisees.

The promises to provide pre-opening services and system maintenance services are not distinct performance obligation because they are attendant to the license of IP. Therefore, the promises to provide pre-opening services and system maintenance services are combined with the license of IP to form a single performance obligation. Hotel management services form a single distinct performance obligation.

Manachised and franchised hotel revenues are derived from franchise agreements where the franchisees are primarily required to pay (i) an initial one-time franchise fee, and (ii) continuing franchise fees, which mainly consist of (a) on-going management and franchise service fees, (b) central reservation system usage fees, system maintenance and support fees and (c) reimbursements for hotel manager fees.

Initial one-time franchise fee is typically fixed and collected upfront and are recognized as revenue over the term of the franchise contract. We do not consider this advance consideration to include a significant financing component, since it is used to protect us from the franchisees failing to adequately complete some or all of its obligations under the contract. These fees are typically collected upfront and are recognized as revenue over the term of the franchise contract.

On-going management and franchise service fees are generally calculated as a certain percentage of the room revenues of the franchised hotel. Generally, management and franchise service fees are due and payable on a monthly basis as services are provided and revenue is recognized over time as services are rendered.

Central reservation system usage fees, other system maintenance and support fees are typically billed and collected monthly along with base management and franchise fees, and revenue is generally recognized as services are provided.