

Huazhu Group Ltd
Form 20-F
April 19, 2019
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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

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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 |

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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

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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

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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

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- *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 |

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| | | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| 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, | | 2018 (RMB) | 2018 (US\$) |
|-----------------------------------|---------------|---------------|-------------------------|---------------|---------------|----------------|
| | | | 2016 (RMB) | 2017 (RMB) | | |
| | (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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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.

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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;

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- 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.

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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.

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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.

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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.

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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

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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.

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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.

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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.

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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 |

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(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.

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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;

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- *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.

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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.

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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.

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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:

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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.

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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.

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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.

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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.

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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.

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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:

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- 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.

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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;

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- 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.

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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.

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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

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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.

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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.

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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.

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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.

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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 |

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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;

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- *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.

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- *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

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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 |

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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.

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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 | | June 30, 2018 | September 30, 2018 | December 31, 2018 |
|---------------------------|-------------------|------------------|-----------------------|----------------------------|-------------------|------------------|-----------------------|----------------------|
| | | | | December 31, 2017 | March 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 | | June 30, 2018 | September 30, 2018 | December 31, 2018 |
|--|-------------------|------------------|-----------------------|----------------------------|-------------------|------------------|-----------------------|----------------------|
| | | | | December 31, 2017 | March 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 |

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(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.

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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\$) | |
| | (In millions except percentages) | | | | | | |
| 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 |

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| | | | | | | | |
|-------------------------------------|-------|------|-------|------|-------|-------|------|
| 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 |

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- Hotel Operating Costs.* Our hotel operating costs consist primarily of costs and expenses directly attributable to the operation of our leased and owned and manachised hotels. Leased and owned hotel operating costs primarily include rental payments and utility costs for hotel properties, compensation and benefits for our hotel-based employees, costs of hotel room consumable products and depreciation and amortization of leasehold improvements, intangible assets and land use rights. Manachised hotel operating costs primarily include compensation and benefits for manachised hotel managers and other limited number of employees directly hired by us, which are recouped by us in the form of monthly service fees. We anticipate that our hotel operating costs in absolute amount will increase as we continue to open new hotels. Our hotel operating costs as a percentage of our net revenue may change from period to period mainly driven by three factors: (i) the hotel operating costs as a percentage of revenues from our leased and owned hotels, (ii) the operating costs, mainly personnel costs, as a percentage of revenues from the manachised and franchised business and (iii) the weight of manachised and franchised hotels in our revenue mix.
- Selling and Marketing Expenses.* Our selling and marketing expenses consist primarily of commissions to travel intermediaries, expenses for marketing programs and materials, bank fees for processing bank card payments, and compensation and benefits for our sales and marketing personnel, including personnel at our centralized reservation center. We expect that our selling and marketing expenses will increase as our sales increase and as we further expand into new geographic locations and promote our brands.
- General and Administrative Expenses.* Our general and administrative expenses consist primarily of compensation and benefits for our corporate and regional office employees and other employees who are not sales and marketing or hotel-based employees, travel and communication expenses of our general and administrative staff, costs of third-party professional services, and office expenses for corporate and regional office. We expect that our general and administrative expenses will increase in the near term as we hire additional personnel and incur additional costs in connection with the expansion of our business.
- Pre-opening Expenses.* Our pre-opening expenses consist primarily of rents, personnel cost, and other miscellaneous expenses incurred prior to the opening of a new leased and owned hotel.

Our pre-opening expenses are largely determined by the number of pre-opening hotels in the pipeline and the rental fees incurred during the development stage. Landlords typically offer a two- to six-month rent-free period at the beginning of the lease. Nevertheless, rental is booked during this period on a straight-line basis. Therefore, a portion of pre-opening expenses is non-cash rental expenses. The following table sets forth the components of our pre-opening expenses for the periods indicated.

| | Year Ended December 31, | | | | (US\$) |
|----------------|-------------------------|---------------|---------------|---------------|--------|
| | 2016 (RMB) | 2017 (RMB) | 2018 (RMB) | 2018 (RMB) | |
| | (In millions) | | | | |
| Rents | 67 | 192 | 221 | | 32 |
| Personnel cost | 2 | 6 | 18 | | 3 |
| Others | 3 | 8 | 16 | | 2 |

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| | | | | |
|----------------------------|----|-----|-----|----|
| 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.

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| | 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.

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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) | (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.

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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

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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.

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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.

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Reimbursements for hotel manager fees, which cover the manachised hotel managers payroll, social welfare benefits and certain other out-of-pocket expenses that we incur on behalf of the manachised hotels. The reimbursements are recognized over time within revenues for the reimbursement of costs incurred on behalf of manachised hotels.

Other Revenues

Our other revenues are derived from activities other than the operation of hotel businesses, which mainly include revenues from Hua Zhu mall and the provision of IT products and services to hotels. Revenues from Hua Zhu mall are commissions charged from suppliers for goods sold through the platform and are recognized upon delivery of goods to end customers when its suppliers obligation is fulfilled. Revenues from IT products are recognized when goods are delivered and revenues from IT services are recognized when services are rendered.

Loyalty Program

Under the loyalty program we administer, members earn loyalty points that can be redeemed for future products and services. Points earned by loyalty program members represent a material right to free or discounted goods or services in the future. The loyalty program has one performance obligation that consists of marketing and managing the program and arranging for award redemptions by members. We are responsible for arranging for the redemption of points, but we do not directly fulfill the redemption obligation except at leased and owned hotels. Therefore, we are the agent with respect to this performance obligation for manachised and franchised hotels, and are the principal with respect to leased and owned hotels.

For leased and owned hotels, a portion of the leased and owned revenues is deferred until a member redeems points. The amount of revenue we recognize upon point redemption is impacted by the estimate of the breakage for points that members will never redeem in our owned and leased hotels.

For manachised and franchised hotels, the portion of revenue deferred by manachised and franchised hotels are collected by us which will be refunded upon redemption of points at manachised and franchised hotels. The estimated breakage for points earned in manachised and franchised hotels are recognized as manachised and franchised revenue for each period. We estimate breakage based on our historical experience and expectations of future member behavior and will true up the estimated breakage at the end of each period.

Membership fees from our customer loyalty program are earned and recognized on a straight-line basis over the expected membership duration of the different membership levels. Such duration is estimated based on our and our management's experience and is adjusted on a periodic basis to reflect changes in membership retention. The membership duration is estimated to be two to five years which reflects the expected membership retention.

Long-Lived Assets

Property and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with ASC 360, Accounting for the Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We evaluate the carrying value of our long-lived assets for impairment by comparing the expected undiscounted future cash flows of the assets to the net book value of the assets if certain trigger events occur, such as receiving government zoning notification. Inherent in reviewing the carrying amounts of the long-lived assets is the use of various estimates. First, our management must determine the usage of the asset. Impairment of an asset is more likely to be recognized where and to the extent our management decides that such asset may be disposed of or sold. Assets must be tested at the lowest level, generally the individual hotel, for which identifiable cash flows exist. If the expected undiscounted future cash flows are less than the net book value of the assets, the excess of the net book value over the estimated fair value is charged to current earnings. Fair value is based upon discounted cash flows of the assets at a rate deemed reasonable for the type of asset and prevailing market conditions, appraisals and, if appropriate, current estimated net sales proceeds from pending offers. Future cash flow estimates are, by their nature, subjective and actual results may differ materially from our estimates. If our ongoing estimates of future cash flows are not met, we may have to record additional impairment charges in future accounting periods. Our estimates of cash flow are based on the current regulatory, social and economic climates where we conduct our operations as well as recent operating information and budgets for our business. These estimates could be negatively impacted by changes in laws and regulations, economic downturns, or other events affecting various forms of travel and access to our hotels.

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Intangible assets acquired in a business combination are recorded at fair value at the date of acquisition. The useful lives of intangible assets are assessed to be either finite or indefinite. Following initial recognition, intangible assets with finite lives are carried at cost less any accumulated amortization and any accumulated impairment losses. Intangible assets with an indefinite life are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the intangible asset to its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized equal in amount to that excess.

Goodwill Impairment

Goodwill is required to be tested for impairment at least annually or more frequently if events or changes in circumstances indicate that these assets might be impaired. If we determine that the carrying value of our goodwill has been impaired, the carrying value will be written down.

We perform a two-step goodwill impairment test for each of the reporting unit we identified for goodwill impairment testing purposes. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying value of a reporting unit exceeds its fair value, we would perform the second step in our assessment process and record an impairment loss to earnings to the extent the carrying amount of the reporting unit's goodwill exceeds its implied fair value. We estimate the fair value of each reporting unit through internal analysis and external valuations, which utilize income and market valuation approaches through the application of capitalized earnings, discounted cash flow as well as market value. These valuation techniques are based on a number of estimates and assumptions, including the projected future operating results of the reporting unit, appropriate discount rates and long-term growth rates. The significant assumptions regarding our future operating performance are revenue growth rates, discount rates and terminal values. If any of these assumptions changes, the estimated fair value of our reporting unit will change, which could affect the amount of goodwill impairment charges, if any. We perform the annual goodwill impairment test on November 30. As of November 30, 2018, we operated and managed our business as a single segment, and the acquired business had been migrated to our business. Our management reviews our consolidated results when making decisions about allocating resources and assessing our performance. Therefore, we have a single operating segment and reporting unit.

Table of Contents***Income Taxes***

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, we recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and tax basis of assets and liabilities. A valuation allowance is required to reduce the carrying amounts of deferred tax assets if, based on the available evidence, it is more likely than not that such assets will not be realized. Accordingly, the need to establish valuation allowances for deferred tax assets is assessed periodically based on a more-likely-than-not realization threshold. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of statutory carryforward periods, our experience with operating loss in the China's limited service hotel industry, tax planning strategy implemented and other tax planning alternatives. Prior to 2009, we had significant operating losses attributable to rapid expansion and related pre-opening costs incurred. As of December 31, 2016, 2017 and 2018, we had deferred tax assets after valuation allowance of RMB254 million, RMB406 million and RMB505 million (US\$73 million), respectively. We expect many of our hotels that were put in operation since 2013 will mature gradually and generate sufficient taxable profit to utilize the substantial portion of the net loss carryforward. If our operating results are less than currently projected and there is no objectively verifiable evidence to support the realization of our deferred tax asset, additional valuation allowance may be required to further reduce our deferred tax asset. The reduction of the deferred tax asset could increase our income tax expenses and have an adverse effect on our results of operations and tangible net worth in the period in which the allowance is recorded.

The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Our tax rate is based on expected income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which we operate. For interim financial reporting, we estimate the annual tax rate based on projected taxable income for the full year and record a quarterly income tax provision in accordance with the anticipated annual rate. As the year progresses, we refine the estimates of the year's taxable income as new information becomes available, including year-to-date financial results. This continual estimation process often results in a change to our expected effective tax rate for the year. When this occurs, we adjust the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision reflects the expected annual tax rate. Significant judgment is required in determining our effective tax rate and in evaluating its tax positions.

We recognize a tax benefit associated with an uncertain tax position when, in our judgment, it is more likely than not that the position will be sustained upon examination by a taxing authority. For a tax position that meets the more-likely-than-not recognition threshold, we initially and subsequently measure the tax benefit as the largest amount that we judge to have a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority. Our liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances, such as the progress of tax audits, case law developments and new or emerging legislation. Such adjustments are recognized entirely in the period in which they are identified. Our effective tax rate includes the net impact of changes in the liability for unrecognized tax benefits and subsequent adjustments as considered appropriate by management. We classify interests and penalties recognized on the liability for unrecognized tax benefits as income tax expense.

Share-Based Compensation

The costs of share based payments are recognized in our consolidated financial statements based on their grant-date fair value over the vesting. We determine fair value of our share options as of the grant date using binomial option pricing model and the fair value of our nonvested restricted stocks as of the grant date based on the fair market value of the underlying ordinary shares. Under the binomial option pricing model, we make a number of assumptions regarding fair value including the expected price multiple at which employee are likely to exercise stock options, the expected volatility of our future ordinary share price, the risk free interest rate and the expected dividend yield. Determining the value of our share-based compensation expense in future periods also requires the input of subjective assumptions around estimated forfeitures

of the underlying shares and likely future performance. The compensation expenses for the awards with performance conditions based upon our judgment of likely future performance and may be adjusted in future periods depending on actual performance. We estimate our forfeitures based on past employee retention rates, our expectations of future retention rates, and we will prospectively revise our forfeiture rates based on actual history. We estimate our future performance based on our historical results. Our compensation charges may change based on changes to our assumptions.

Table of Contents*Future Adoption of Accounting Standards*

See Note 2 Summary of Principal Accounting Policies - Recently Issued Accounting Pronouncements for our current evaluation of the impact of adopting Accounting Standards Update No. 2016-02 (ASU 2016-02), *Leases*, and other accounting standards effective in future periods.

Results of Operations

The following table sets forth a summary of our consolidated results of operations, both in absolute amount and as a percentage of net revenues for the periods indicated. This information should be read together with our consolidated financial statements and related notes included elsewhere in this annual report.

We have grown rapidly since we began our current business of operating and managing a multi-brand hotel group in 2007. Our relatively limited operating history makes it difficult to predict our future operating results. We believe that the year-to-year comparison of operating results should not be relied upon as being indicative of future performance.

| | 2016 | | Year Ended December 31, 2017 | | | 2018 | |
|---|-------|-------|---------------------------------|-------|--------|--------|-------|
| | RMB | % | RMB | % | (RMB) | (US\$) | % |
| (In millions except percentages) | | | | | | | |
| Consolidated Statement of Comprehensive Income Data: | | | | | | | |
| Revenues: | | | | | | | |
| Leased and owned hotels | 5,239 | 79.7 | 6,338 | 77.0 | 7,470 | 1,087 | 74.2 |
| Manachised and franchised hotels | 1,419 | 21.6 | 1,851 | 22.5 | 2,527 | 368 | 25.1 |
| Others | 31 | 0.5 | 40 | 0.5 | 66 | 9 | 0.7 |
| Total revenues | 6,689 | 101.8 | 8,229 | 100.0 | 10,063 | 1,464 | 100.0 |
| Less: Business tax and related taxes | 116 | 1.8 | | | | | |
| Net revenues | 6,573 | 100.0 | 8,229 | 100.0 | 10,063 | 1,464 | 100.0 |
| Operating costs and expenses(1): | | | | | | | |
| 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 expenses | 209 | 3.2 | 285 | 3.5 | 348 | 50 | 3.5 |
| 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 |
| Other operating (expense) income, net | (17) | (0.3) | 71 | 0.9 | 226 | 32 | 2.3 |
| Income from operations | 841 | 12.7 | 1,426 | 17.3 | 2,344 | 341 | 23.3 |
| Interest income | 67 | 1.0 | 113 | 1.4 | 148 | 21 | 1.5 |
| Interest expenses | 11 | 0.2 | 87 | 1.1 | 244 | 35 | 2.4 |
| Other income, net | 134 | 2.1 | 128 | 1.6 | 203 | 30 | 2.0 |
| Unrealized gain (loss) from fair value changes of equity securities | | | 35 | 0.4 | (914) | (133) | (9.1) |

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| | | | | | | | |
|---|-------|-------|-------|-------|-------|------|-------|
| Foreign exchange gain (loss) | 16 | 0.3 | (18) | (0.2) | (144) | (21) | (1.4) |
| Income before income taxes | 1,047 | 15.9 | 1,597 | 19.4 | 1,393 | 203 | 13.9 |
| Income tax expense | 279 | 4.2 | 357 | 4.3 | 569 | 83 | 5.7 |
| Income (loss) from equity method investments | 6 | 0.1 | (12) | (0.2) | (97) | (14) | (1.0) |
| Net income | 774 | 11.8 | 1,228 | 14.9 | 727 | 106 | 7.2 |
| Less: net (loss) income attributable to noncontrolling interest | (8) | (0.1) | 0 | 0 | 11 | 2 | 0.1 |
| Net income attributable to Huazhu Group Limited | 782 | 11.9 | 1,228 | 14.9 | 716 | 104 | 7.1 |

Note:

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

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

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Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

Net Revenues. Our net revenues increased by 22.3% from RMB8,229 million in 2017 to RMB10,063 million (US\$1,464 million) in 2018.

- *Leased and Owned Hotels.* Net revenues from our leased and owned hotels increased by 17.9% from RMB6,338 million in 2017 to RMB7,470 million (US\$1,087 million) in 2018. This increase was primarily due to (1) our continued expansion of leased and owned hotels from 671 hotels and 85,018 hotel rooms as of December 31, 2017 to 699 hotels and 86,787 hotel rooms as of December 31, 2018; and (2) our RevPAR growth from RMB211 in 2017 to RMB237 in 2018. The increase of RevPAR for our leased and owned hotels was mainly as a result of the increase in the proportion of midscale and upscale hotels.
- *Manachised and Franchised Hotels.* Net revenues from our manachised and franchised hotels increased by 36.6% from RMB1,851 million in 2017 to RMB2,527 million (US\$368 million) in 2018. This increase was primarily due to our continued expansion of manachised hotels from 2,874 hotels and 275,065 hotel rooms as of December 31, 2017 to 3,309 hotels and 314,932 hotel rooms as of December 31, 2018 and franchised hotels from 201 hotels and 19,592 hotel rooms as of December 31, 2017 to 222 hotels and 21,028 hotel rooms as of December 31, 2018. RevPAR for our manachised and franchised hotels increased from RMB171 and RMB158 in 2017 to RMB186 (US\$27) and RMB188 (US\$27) in 2018, respectively, mainly attributable to the upgrade of economy hotels and the increase in the proportion of midscale and upscale hotels.

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- *Other Revenues.* Net other revenues increased from RMB40 million in 2017 to RMB66 million (US\$9 million) in 2018. This increase was primarily attributable to the increase of revenues from provision of IT products and services to hotels.

Operating Costs and Expenses. Our total operating costs and expenses increased by 15.6% from RMB6,874 million in 2017 to RMB7,945 million (US\$1,155 million) in 2018.

- *Hotel Operating Costs.* Our hotel operating costs increased by 14.1% from RMB5,675 million in 2017 to RMB6,476 million (US\$942 million) in 2018. This increase was primarily due to our expansion of leased and owned hotels from 671 hotels as of December 31, 2017 to 699 hotels as of December 31, 2018 and the increased proportion of our midscale and upscale hotels. The increase in personnel costs, part of hotel operating costs, was also attributable to our expansion of manachised hotels from 2,874 hotels as of December 31, 2017 to 3,309 hotels as of December 31, 2018. Our hotel operating costs as a percentage of net revenues decreased from 69.0% in 2017 to 64.4% in 2018. The year-over-year decrease in the percentage was mainly attributable to the improved blended RevPAR and the increased portion of manachised and franchised hotels.

- *Selling and Marketing Expenses.* Our selling and marketing expenses increased by 22.1% from RMB285 million in 2017 to RMB348 million (US\$50 million) in 2018. The increase was in line with the growth of our revenues. Our selling and marketing expenses as a percentage of net revenues remained stable at 3.5% in both 2017 and 2018.

- *General and Administrative Expenses.* Our general and administrative expenses increased from RMB691 million in 2017 to RMB851 million (US\$124 million) in 2018. Our general and administrative expenses as a percentage of net revenues increased from 8.4% in 2017 to 8.5% in 2018. The increase was mainly attributable to the increase of performance-related personnel costs.

- *Pre-opening Expenses.* Our pre-opening expenses increased from RMB206 million in 2017 to RMB255 million (US\$37 million) in 2018. The increase was mainly attributable to more leased midscale and upscale hotels opened or under construction in 2018. Our pre-opening expenses as a percentage of net revenues remained stable at 2.5% in both 2017 and 2018.

Other Operating Income, Net. Our other operating income was RMB226 million (US\$32 million) in 2018, which mainly included government grants of RMB106 million, gains related to compensations for termination of certain leased hotels of RMB67 million and reversal of contingent loss of RMB25 million, as well as the compensation of RMB35 million received from the selling shareholders of Crystal Orange as the final settlement of the sales and purchase transaction. Our other operating income was RMB71 million in 2017, which mainly included government grants.

Income from Operations. As a result of the foregoing, we had income from operations of RMB2,344 million (US\$341 million) in 2018, compared to income from operations of RMB1,426 million in 2017.

Interest Income (Expense), Net. Our net interest expense was RMB96 million (US\$14.0 million) in 2018. Our interest income was RMB148 million (US\$21 million), and our interest expense was RMB244 million (US\$35 million) in 2018. Our net interest income was RMB26 million in 2017. Our interest income was RMB113 million, and our interest expense was RMB87 million in 2017. The change from net interest income in 2017 to net interest expense in 2018 was primarily due to our increased bank borrowings in 2018 and the convertible senior notes we issued in November 2017.

Other Income, Net. Our other income was RMB128 million and RMB203 million (US\$30 million) in 2017 and 2018, respectively, primarily attributable to the investment income from our equity investments including RMB104 million (US\$15 million) of dividends received from Accor in the third quarter of 2018.

Unrealized gains (losses) from fair value changes of equity securities. Our unrealized losses from fair value changes of equity securities was RMB914 million (US\$133 million) in 2018, compared with unrealized gains from fair value changes of equity securities of RMB35 million in 2017, primarily related to our investment in Accor.

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Foreign Exchange Gain (Loss). Our foreign exchange loss increased from RMB18 million in 2017 to RMB144 million (US\$21 million) in 2018, which was primarily attributable to the exchange loss related to our investment in Accor in Euro, partially offset by the EUR241 million bank borrowings exchange gain, as the Euro depreciated against the U.S. dollar in 2018.

Income Tax Expense. Our income tax expenses increased from RMB357 million in 2017 to RMB569 million (US\$83 million) in 2018. Our effective tax rate in 2018 was 40.8%, which increased from 22.4% in 2017, primarily reflected certain non-taxable loss of the fair value changes in equity securities investments and a withholding tax accrued on our dividends declaration.

Loss from Equity Method Investments. Our loss from equity method investments increased from RMB12 million in 2017 to RMB97 million (US\$14 million) in 2018, primarily due to the loss incurred by certain investees.

Net Income Attributable to Noncontrolling Interest. Net income attributable to noncontrolling interest represents joint venture partners' share of our net income or loss based on their equity interest in the leased and owned hotels owned by the joint ventures. Net income attributable to noncontrolling interest was RMB11 million (US\$2 million) in 2018, primarily due to profits from certain of our joint ventures. The net income (loss) attributable to noncontrolling interest was not material in 2017.

Net Income Attributable to Huazhu Group Limited. As a result of the foregoing, we had net income attributable to Huazhu Group Limited of RMB716 million (US\$104 million) in 2018 compared to net income attributable to Huazhu Group Limited of RMB1,228 million in 2017.

EBITDA and Adjusted EBITDA. EBITDA (non-GAAP) was RMB2,272 million (US\$331 million) in 2018, compared with EBITDA of RMB2,348 million in 2017. Adjusted EBITDA (non-GAAP) increased from RMB2,379 million in 2017 to RMB3,269 million (US\$476 million) in 2018. This change was primarily due to the expansion of our hotel network, the improved RevPAR and the increased proportion of managed and franchised hotels in 2018.

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Net Revenues. Our net revenues increased by 25.2% from RMB6,573 million in 2016 to RMB8,229 million in 2017.

- *Leased and Owned Hotels.* Net revenues from our leased and owned hotels increased by 21.0% from RMB5,239 million in 2016 to RMB6,338 million in 2017. This increase was primarily due to our continued expansion of leased and owned hotels from 624 hotels and 78,160 hotel rooms as of December 31, 2016 to 671 hotels and 85,018 hotel rooms as of December 31, 2017. The increase of RevPAR for our leased and owned hotels from RMB179 in 2016 to RMB211 in 2017, mainly as a result of the increase in the proportion of midscale and upscale hotels and the improved performance driven by strong travel demand.
- *Manachised and Franchised Hotels.* Net revenues from our manachised and franchised hotels increased by 30.4% from RMB1,419 million in 2016 to RMB1,851 million in 2017. This increase was primarily due to our continued expansion of manachised hotels from 2,471 hotels and 237,094 hotel rooms as of December 31, 2016 to 2,874 hotels and 275,065 hotel rooms as of December 31, 2017 and franchised hotels from 174 hotels and 16,093 hotel rooms as of December 31, 2016 to 201 hotels and 19,592 hotel rooms as of December 31, 2017. RevPAR for our manachised and franchised hotels increased from RMB151 and RMB125 in 2016 to RMB171 and RMB158 in 2017, respectively, mainly attributable to the upgrade of economy hotels and increasing travel demands.
- *Other Revenues.* Net other revenues increased from RMB31 million in 2016 to RMB40 million in 2017. This increase was primarily attributable to the increase of revenues from provision of IT products and services to hotels.

Operating Costs and Expenses. Our total operating costs and expenses increased by 20.3% from RMB5,715 million in 2016 to RMB6,874 million in 2017.

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- *Hotel Operating Costs.* Our hotel operating costs increased by 15.0% from RMB4,934 million in 2016 to RMB5,675 million in 2017. This increase was primarily due to our expansion of leased and owned hotels from 624 hotels as of December 31, 2016 to 671 hotels as of December 31, 2017 and the increased proportion of our midscale and upscale hotels. The increase in personnel costs, part of hotel operating costs, was also attributable to our expansion of manachised hotels from 2,471 hotels as of December 31, 2016 to 2,874 hotels as of December 31, 2017. Our hotel operating costs as a percentage of net revenues decreased from 75.1% in 2016 to 69.0% in 2017. The year-over-year decrease in the percentage was mainly attributable to the improved blended RevPAR and the increased portion of manachised and franchised hotels.

- *Selling and Marketing Expenses.* Our selling and marketing expenses increased by 36.4% from RMB209 million in 2016 to RMB285 million in 2017. Our selling and marketing expenses as a percentage of net revenues increased from 3.2% in 2016 to 3.5% in 2017. The increase was mainly attributable to the redesign of a number of our hotel brands as well as marketing activities to promote our brands and loyalty programs.

- *General and Administrative Expenses.* Our general and administrative expenses increased from RMB492 million in 2016 to RMB691 million in 2017. Our general and administrative expenses as a percentage of net revenues increased from 7.5% in 2016 to 8.4% in 2017. The increase was mainly attributable to the increase of performance-related personnel costs, general and administrative expenses related to the newly acquired Crystal Orange, and one-off Crystal Orange acquisition transaction costs amounting to RMB46.2 million in the first half of 2017.

- *Pre-opening Expenses.* Our pre-opening expenses increased from RMB72 million in 2016 to RMB206 million in 2017. Our pre-opening expenses as a percentage of net revenues increased from 1.1% in 2016 to 2.5% in 2017. These increases were mainly attributable to more leased midscale and upscale hotels opened or under construction in 2017 than in 2016.

Other Operating Income (Expense), Net. Our other operating income was RMB71 million in 2017, which mainly included government grants. Our other operating expense was RMB17 million in 2016, which mainly included accrued contingencies for certain of our pending legal and administrative proceedings, partially offset by government grants.

Income from Operations. As a result of the foregoing, we had income from operations of RMB1,426 million in 2017, compared to income from operations of RMB841 million in 2016.

Interest Income (Expense), Net. Our net interest income was RMB26 million in 2017. Our interest income was RMB113 million in 2017, and our interest expense was RMB87 million. Our net interest income was RMB56 million in 2016. Our interest income was RMB67 million in 2016, and our interest expense was RMB11 million. The decrease in net

interest income from 2016 to 2017 was primarily due to our increased bank borrowings and issuance of convertible senior notes in 2017.

Other Income, Net. Our other income was RMB134 million and RMB128 million in 2016 and 2017, respectively, primarily attributable to the investment income from our equity investments.

Foreign Exchange Gain (Loss). We had foreign exchange loss of RMB18 million in 2017, compared to foreign exchange gain of RMB16 million in 2016. Our foreign exchange loss in 2017 was primarily attributable to the appreciation of the Renminbi against the U.S. dollar in 2017.

Income Tax Expense. Our income tax expenses increased from RMB279 million in 2016 to RMB357 million in 2017, primarily due to the increase in our income before income taxes from RMB1,047 million in 2016 to RMB1,597 million in 2017. Our effective tax rate in 2017 was 22.4%, which decreased from 26.6% in 2016, primarily due to the influence of withholding tax on cash dividend in 2016 and the effect of excess tax benefit of share-based compensation in 2017. The effect of excess tax benefit was recorded in additional paid-in capital before 2017. With the adoption of ASU 2016-09, the tax benefit for options and equity awards is recognized in the income statement that lead to a RMB46.2 million decrease in income tax expenses in 2017

Income (Loss) from Equity Method Investments. Our loss from equity method investments was RMB12 million in 2017, compared to our income from equity method investments of RMB6 million in 2016, primarily due to the loss incurred by certain investees.

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Net Income (Loss) Attributable to Noncontrolling Interest. Net income (loss) attributable to noncontrolling interest represents joint venture partners' share of our net income or loss based on their equity interest in the leased and owned hotels owned by the joint ventures. We incurred net loss attributable to noncontrolling interest of RMB8 million in 2016, primarily due to losses of certain of our new joint ventures. The net income (loss) attributable to noncontrolling interest was not material in 2017.

Net Income Attributable to Huazhu Group Limited. As a result of the foregoing, we had net income attributable to Huazhu Group Limited of RMB1,228 million in 2017 compared to net income attributable to Huazhu Group Limited of RMB782 million in 2016.

EBITDA and Adjusted EBITDA. EBITDA (non-GAAP) was RMB2,348 million in 2017, compared with EBITDA of RMB1,700 million in 2016. Adjusted EBITDA (non-GAAP) increased from RMB1,755 million in 2016 to RMB2,379 million in 2017. This change was primarily due to the expansion of our hotel network, the improved RevPAR and the acquisition of Crystal Orange in 2017.

Outstanding Indebtedness

In May 2017, we entered into an US\$250 million term facility and US\$250 million revolving credit facility agreement. The US\$250 million revolving credit facility is available for 35 months after the date of the agreement. The interest rate on the loan is Libor plus 1.75%. There are some financial covenants including interest cover, leverage and tangible net worth related to this facility. In 2017, we had drawn down US\$250 million under the term facility agreement and repaid nil in both 2017 and 2018. For revolving credit facility agreement, we had drawn down US\$250 million in May 2017 and fully repaid the amount in November 2017. In 2018, we drew down US\$370 million in succession under the revolving facility agreement and repaid US\$120 million in 2018. The weighted average interest rate of borrowings drawn under this agreement was 3.04% and 3.93% for the year ended December 31, 2017 and 2018, respectively.

In February 2018, we entered into a three-year term facility agreement under which we can borrow up to EUR260 million within 30 London business days. The interest rate on the loan for each interest period is the applicable EURIBOR plus 1.70%. We have pledged 13,092,112 shares of Accor we acquired from open market in 2017 and 2018 as collateral to secure this facility. There are some covenants including the debt ratio and the value of the pledged shares and it was in compliance as of December 31, 2018. We had drawn down EUR241 million under the term facility agreement in 2018 and repaid nil. The weighted average interest rate of borrowings drawn under this agreement was 1.70% for the year ended December 31 2018.

In November 2017, we issued US\$475.0 million of 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).

5.B. Liquidity and Capital Resources

Our principal sources of liquidity have been cash generated from operating activities, borrowings from commercial banks and issuance of convertible senior notes. Our cash and cash equivalents consist of cash on hand and liquid investments which have maturities of three months or less when acquired and are unrestricted as to withdrawal or use. As of December 31, 2018, we had 42 properties for our leased and owned hotels under development. As of December 31, 2018, we expected to incur approximately RMB1,499 million of capital expenditures in connection with certain recently completed leasehold improvements and to fund the leasehold improvements of these 42 leased and owned hotels. We intend to fund this planned expansion with our operating cash flow, our cash balance and our credit facilities.

We have been able to meet our working capital needs, and we believe that we will be able to meet our working capital needs for at least the next 12 months with our operating cash flow, existing cash balance and our credit facilities (including the undrawn bank facilities currently available to us and bank facilities we plan to obtain in 2019).

The following table sets forth a summary of our cash flows for the periods indicated:

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| | 2016 (RMB) | Year Ended December 31, | | 2018 (US\$) |
|---|---------------|-------------------------|-------|----------------|
| | | 2017 (RMB) | (RMB) | |
| | (In millions) | | | |
| Net cash provided by operating activities | 2,066 | 2,453 | 3,049 | 444 |
| Net cash used in investing activities | 176 | 6,235 | 6,345 | 923 |
| Net cash (used in) provided by financing activities | (266) | 4,536 | 4,248 | 618 |
| Effect of exchange rate changes on cash and cash equivalents, and restricted cash | 14 | (34) | (24) | (3) |
| Net increase in cash, cash equivalents and restricted cash | 1,638 | 720 | 928 | 136 |
| Cash, cash equivalents and restricted cash at the beginning of the year | 1,598 | 3,236 | 3,956 | 575 |
| Cash, cash equivalents and restricted cash at the end of the year | 3,236 | 3,956 | 4,884 | 711 |

Operating Activities

In 2016, 2017 and 2018, we financed our operating activities primarily through cash generated from operations.

Net cash provided by operating activities amounted to RMB3,049 million (US\$444 million) in 2018, primarily attributable to (i) our net income of RMB727 million (US\$106 million), (ii) an add-back of RMB1,009 million (US\$147 million) in investment loss, (iii) an add-back of 891 million (US\$130 million) in depreciation and amortization, (iv) an add-back of RMB157 million (US\$23 million) of loss from equity method investments, net of dividends; (v) an add-back of RMB140 million (US\$20 million) in the deferred rent because rental accrued on a straight-line basis exceeded rental paid out of our contractual liabilities and (vi) an increase of RMB140 million (US\$20 million) in accrued expenses and other current liabilities, partially offset by an increase of prepaid rent of RMB283 million (US\$41 million).

Net cash provided by operating activities amounted to RMB2,453 million in 2017, primarily attributable to (i) our net income of RMB1,228 million, (ii) an add-back of RMB789 million in depreciation and amortization, (iii) an increase of RMB278 million in accrued expenses and other current liabilities, (iv) an add-back of RMB209 million in the deferred rent because rental accrued on a straight-line basis exceeded rental paid out of our contractual liabilities and (v) an add-back of RMB169 million of impairment loss, partially offset by an increase of prepaid rent of RMB189 million.

Net cash provided by operating activities amounted to RMB2,066 million in 2016, primarily attributable to (i) our net income of RMB774 million in 2016, (ii) an add-back of RMB695 million in depreciation and amortization, (iii) an increase of RMB225 million in accrued expenses and other current liabilities, (iv) an add-back of RMB154 million of impairment loss, (v) an add-back of RMB103 million in deferred rent because rental accrued on a straight-line basis exceeded rental paid out of our contractual liabilities.

Net cash provided by operating activities increased from RMB2,453 million in 2017 to RMB3,049 million (US\$444 million) in 2018, primarily due to our strong core operation performance, a change from investment income of RMB160 million in 2017 to investment loss of RMB1,009

million (US\$147 million) in 2018, partially offset by a decrease in our net income from RMB1,228 million in 2017 to RMB727 million (US\$106 million) in 2018.

Net cash provided by operating activities increased from RMB2,066 million in 2016 to RMB2,453 million in 2017, primarily due to (i) an increase in our net income from RMB774 million in 2016 to RMB1,228 million in 2017, (ii) an increase in the add-back of our deferred rent from RMB103 million in 2016 to RMB209 million in 2017, and (iii) an increase in accrued expenses and other current liabilities from RMB225 million in 2016 to RMB278 million in 2017, partially offset by an increase in our prepaid rent from RMB25 million in 2016 to RMB189 million in 2017.

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Investing Activities

Our cash used in investing activities in 2018 is primarily related to our leasehold improvements, purchase of equipment, fixtures in leased and owned hotels, acquisition of Blossom Hill, purchase of marketable securities from the open market and investment in hotel related funds and Cjia.

Net cash used in investing activities increased from RMB6,235 million in 2017 to RMB6,345 million (US\$923 million) in 2018, primarily due to (i) an increase in purchases of long-term investments from RMB1,328 million in 2017 to RMB4,959 million (US\$721 million) in 2018, mainly due to the purchase of equity securities of Accor and the investment in several hotel related funds and Cjia, (ii) an increase in our purchase of property and equipment from RMB819 million in 2017 to RMB1,115 million (US\$162 million) in 2018, partially offset by a decrease in acquisitions, net of cash received from RMB3,746 million in 2017 to RMB496 million (US\$72 million) in 2018, mainly due to the acquisition of Crystal Orange in 2017.

Net cash used in investing activities was RMB6,235 million in 2017, compared to net cash used in investing activities of RMB176 million in 2016, primarily due to (i) a change in acquisitions, net of cash received from positive RMB132 million in 2016 to negative RMB3,746 million in 2017, mainly due to the acquisition of Crystal Orange, (ii) an increase in our purchase of long-term investments from RMB293 million in 2016 to RMB1,328 million in 2017, (iii) a decrease in our proceeds from maturity/sale of short-term investments from RMB526 million in 2016 to nil in 2017, mainly due to the disposal of all our investment in Home Inns in 2016 (iv) an increase in our payment for the origination of loan receivables from RMB36 million in 2016 to RMB446 million in 2017 and (v) an increase in our purchases of property and equipment from RMB503 million in 2016 to RMB819 million in 2017.

Financing Activities

Our major financing activities since 2016 consist of loans with commercial banks, issuance of convertible senior notes and payment of dividends.

Net cash provided by financing activities decreased from RMB4,536 million in 2017 to RMB4,248 million (US\$618 million) in 2018. Net cash provided by financing activities in 2018 primarily consisted of (i) proceeds of RMB4,275 million (US\$622 million) from long-term debt and (ii) proceeds of RMB928 million (US\$135 million) from short-term debt, partially offset by (i) repayment of long-term debt of RMB799 million (US\$116 million), (ii) repayment of short-term debt of RMB128 million (US\$19 million).

Net cash provided by financing activities in 2017 primarily consisted of (i) proceeds of RMB3,633 million from long-term debt, (ii) proceeds of RMB2,925 million from issuance of convertible senior notes, net of issuance cost and capped call option, (iii) proceeds of RMB137 million from short-term debt, partially offset by (i) repayment of long-term debt of RMB1,651 million, (ii) dividend payment of RMB306 million, (iii) repayment of short-term debt of RMB295 million.

Net cash used in financing activities in 2016 primarily consisted of (i) repayment of RMB333 million from short-term debt, and (ii) dividend paid of RMB276 million, partially offset by (i) proceeds of RMB282 million from short-term debt, (ii) contribution from noncontrolling interest holders in the amount of RMB46 million, (iii) net proceeds of RMB12 million from issuance of ordinary shares upon exercise of options, and (iv) funds advanced from noncontrolling interest holders in the amount of RMB12 million.

Restrictions on Cash Transfers to Us

We are a holding company with no material operations of our own. We conduct our operations primarily through our subsidiaries in China. As a result, our ability to pay dividends and to finance any debt we may incur depends upon dividends paid to us by our subsidiaries. If our subsidiaries or any newly formed subsidiaries incur debt on their own behalf in the future, the instruments governing their debt may restrict their ability to pay dividends to us. In addition, our subsidiaries are permitted to pay dividends to us only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. Pursuant to laws applicable to entities incorporated in the PRC, our subsidiaries in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires an annual appropriation of 10% of after-tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of its registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for the specific purposes of enterprise expansion, staff bonus and welfare, and are not distributable as cash dividends. In addition, due to restrictions on the distribution of share capital from our PRC subsidiaries, the share capital of our PRC subsidiaries is considered restricted. As a result of the PRC laws and regulations, as of December 31, 2018, approximately RMB3,279 million (US\$477 million) was not available for distribution to us by our PRC subsidiaries in the form of dividends, loans, or advances.

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Furthermore, under regulations of the SAFE, the Renminbi is not convertible into foreign currencies for capital account items, such as loans, repatriation of investments and investments outside of China, unless the prior approval of the SAFE is obtained and prior registration with the SAFE is made.

The EIT Law provides that enterprises established outside of China whose de facto management bodies are located in China are considered resident enterprises. Currently, it is still unclear whether the PRC tax authorities would determine that we should be classified as a PRC resident enterprise. See Item 10. Additional Information E. Taxation PRC Taxation.

The EIT Law imposes a withholding tax of 10% on dividends distributed by a 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 preferential 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.

The EIT Law provides that PRC resident enterprises are generally subject to the uniform 25% enterprise income tax rate on their worldwide income. Therefore, if we are treated as a PRC resident enterprise, we will be subject to PRC income tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income and results of operations, although we would be exempted from enterprise income tax on dividends distributed from our PRC subsidiaries to us, since such income received by PRC resident enterprise is tax exempted under the EIT Law.

We do not expect any of such restrictions or taxes to have a material impact on our ability to meet our cash obligations.

Capital Expenditures

Our capital expenditures were incurred primarily in connection with leasehold improvements, investments in furniture, fixtures and equipment and technology, information and operational software. Our capital expenditures totaled RMB495 million, RMB1,069 million and RMB1,451 million (US\$211 million) in 2016, 2017 and 2018, respectively. Our capital expenditures in 2018 consist of RMB1,371 million (US\$199 million) in property and equipment and RMB4 million (US\$1 million) in software, and RMB76 million (US\$11 million) in land use right. We will continue to make capital expenditures to meet the expected growth of our operations and expect our cash balance, cash generated from our operating activities and credit facilities will meet our capital expenditure needs in the foreseeable future.

5.C. Research and Development, Patents and Licenses, etc.

See Item 4. Information on the Company B. Business Overview Hotel Information Platform and Operational Systems and Intellectual Property .

5.D. Trend Information

Our wholly owned subsidiary, Jizhu Information and Technology (Shanghai) Co., Ltd (Jizhu Shanghai), which once called Mengguang Information and Technology (Shanghai) Co., Ltd, as recognized software development entity located in Shanghai of PRC, is entitled to a two-year exemption and three-year 50% reduction starting from the first profit making year after absorbing all prior years tax losses. Jizhu Shanghai has entered into the first tax profitable year for the year ended December 31, 2014. Therefore, Jizhu Shanghai applied tax exemption from 2014 to 2015, and was subject to a preferential tax rate of 12.5% from 2016 to 2018. Hanting Suzhou was entitled to a reduced tax rate of 15% as it was qualified as high and new tech enterprise. The high and new tech enterprise qualification was expired in September, 2017, resulting Hanting Suzhou subject to a uniform tax rate of 25% in 2017 and 2018. The aggregate amount and per share effect of tax holidays were as follows:

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| | 2016 (RMB) | Year Ended December 31, 2017 (RMB) (In millions, except per share data) | 2018 (RMB) |
|--------------------------|---------------|---|---------------|
| Aggregate amount | 27 | 24 | 31 |
| Per share effect basic | 0.10 | 0.09 | 0.11 |
| Per share effect diluted | 0.10 | 0.08 | 0.10 |

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the current fiscal year that are reasonably likely to have a material adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

5.E. Off-Balance Sheet Arrangements

Other than operating lease and purchase obligations set forth in the table under Item 5. Operating and Financial Review and Prospects F. Tabular Disclosure of Contractual Obligations, we have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder's equity, or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

5.F. Tabular Disclosure of Contractual Obligations

The following table sets forth our contractual obligations as of December 31, 2018:

| | Total | Payment Due in the Year Ending December 31, (In RMB millions) | | | | 2023 | Payment Due Thereafter |
|---|--------|--|-------|-------|-------|-------|---------------------------|
| | | 2019 | 2020 | 2021 | 2022 | | |
| Operating Lease Obligations | 29,372 | 2,854 | 2,863 | 2,777 | 2,661 | 2,548 | 15,669 |
| Purchase Obligations | 91 | 91 | | | | | |
| Bank Borrowing and Other Debt, with Principal and Interest | 6,855 | 1,148 | 3,803 | 1,904 | | | |
| Convertible Senior Notes with Principal and Interest | 3,302 | 12 | 12 | 12 | 3,266 | | |
| Total | 39,620 | 4,105 | 6,678 | 4,693 | 5,927 | 2,548 | 15,669 |

Our operating lease obligations related to our obligations under lease agreements with lessors of our leased hotels. Our purchase obligations primarily consisted of contractual commitments in connection with leasehold improvements and installation of equipment for our leased hotels.

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As of December 31, 2018, we recorded liabilities of uncertain tax benefits of approximately RMB14 million (US\$2 million) associated with the interests on intercompany loans.

As of December 2018, we obtained a long-term debt of US\$500 million with some financial covenants including interest cover, leverage and tangible net worth. The annual interest rate of the borrowings was approximately 3.93% for the year ended December 31, 2018. We obtained another long term facility of EUR260 million collateralized by 13,092,112 shares of Accor we owned. This loan also has covenants including debt ratio and the value of pledged shares.

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Our Notes are in the aggregate principal amount of US\$475.0 million and will mature in November 2022, unless earlier repurchased or converted into our ADSs based on 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. The conversion rate is subject to adjustment upon occurrence of certain events. The holders may require us to repurchase all or portion of the Notes for cash on November 3, 2020, or upon a fundamental change, at a repurchase price equal to 100% of the principal amount, plus accrued and unpaid interest. The notes 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.

5.G. Safe Harbor

This annual report on Form 20-F contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to us. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties, and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

- our anticipated growth strategies, including developing new hotels at desirable locations in a timely and cost-effective manner and launching a new hotel brand;
- our future business development, results of operations and financial condition;
- expected changes in our revenues and certain cost or expense items;
- our ability to attract customers and leverage our brand; and
- trends and competition in the lodging industry.

In some cases, you can identify forward-looking statements by terms such as may, could, will, should, would, expect, plan, intend, believe, estimate, predict, potential, future, is/are likely to, project or continue or the negative of these terms or other comparable terms. These statements are only predictions. You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which are, in some cases, beyond our control and which could materially affect results. Factors that may cause actual results to differ materially from current expectations include, among other things, those listed under Item 3. Key Information D. Risk Factors and elsewhere in this annual report. If one or more of these risks or uncertainties occur, or if our underlying assumptions prove to be incorrect, actual events or results may vary significantly from those implied or projected by the forward-looking statements. No forward-looking statement is a guarantee of future performance.

The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

ITEM 6.***DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES*****6.A. Directors and Senior Management**

The following table sets forth the name, age and position of each of our directors and executive officers as of the date of this annual report. The business address of all of our directors and executive officers is No. 2266 Hongqiao Road, Changning District, Shanghai 200336, People's Republic of China.

| Directors and Executive Officers | Age | Position/Title |
|---|------------|---|
| Qi Ji | 52 | Founder, Executive Chairman of the Board of Directors |
| John Jiong Wu | 51 | Co-founder, Independent Director |
| Tong Tong Zhao | 52 | Co-founder, Independent Director |
| Xiaofan Wang | 43 | Director |
| Shangzhi Zhang | 65 | Director |
| Jian Shang | 51 | Independent Director |
| Sébastien Bazin | 57 | Director |
| Gaurav Bhushan | 47 | Alternate Director to Sébastien Bazin |
| Min (Jenny) Zhang | 45 | Chief Executive Officer |
| Teo Nee Chuan | 48 | Chief Financial Officer |
| Hui Jin | 41 | President |

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Qi Ji is our founder and has also served as the executive chairman of our board since February 2007. He also served as our chief executive officer from January 2012 to May 2015 and from 2007 to August 2009. He co-founded Home Inns & Hotels Management Inc., or Home Inns, and served as its chief executive officer from January 2001 to January 2005. He also co-founded Ctrip, one of the largest online travel services providers in China, in 1999, acted as its chief executive officer and president until December 2001, and currently serves on Ctrip's board as an independent director. Prior to founding Ctrip, Mr. Ji was the chief executive officer of Shanghai Sunflower High-Tech Group, which he founded in 1997. He headed the East China Division of Beijing Zhonghua Yinghua Intelligence System Co., Ltd. from 1995 to 1997. Mr. Ji received both his master's and bachelor's degrees from Shanghai Jiao Tong University.

John Jiong Wu, a co-founder of our company, has served as our director since January 2007. He is the founder and managing partner of FengHe Fund Management Pte. Ltd. He served as the venture partner of Northern Light Venture Capital from 2008 to 2010 and was an angel investor and the chief technology officer of Alibaba Group from 2000 to 2007. Prior to joining Alibaba Group, he worked as an engineer or manager in several companies in the Silicon Valley, including Oracle and Yahoo! Inc. Mr. Wu received his Bachelor of Science in Computer Science degree from the University of Michigan.

Tong Tong Zhao, a co-founder of our company, has served as our director since February 2007. She also serves as a member of the board of directors of China Education & Technology Group Limited. She was the general manager of Shanghai Asia-Tang Health Technology Development Co., Ltd. from 2004 to 2006, the general manager of Shanghai Hong Ying Hi-Tech Co., Ltd. from 1999 to 2001, and the deputy general manager of Shanghai Xie Cheng Science and Technology Co., Ltd. from 1997 to 1998. Ms. Zhao received her Master of Science degree from Shanghai Jiao Tong University and obtained her Master of Business Administration degree from McGill University.

Xiaofan Wang has served as our director since January 2018. She has served as chief financial officer of Ctrip since November 2013 and executive vice president of Ctrip since May 2016. Ms. Wang joined Ctrip in 2001 and has held a number of managerial positions at Ctrip. Prior to joining Ctrip, she served as finance manager in China eLabs, a venture capital firm from 2000 to 2001. Previously, Ms. Wang worked with PricewaterhouseCoopers Zhong Tian CPAs Limited Company. Ms. Wang received a Master of Business Administration from Massachusetts Institute of Technology and obtained her bachelor's degree from Shanghai Jiao Tong University. Ms. Wang is a Certified Public Accountant (CPA).

Shangzhi Zhang has served as our director since June 2016. He has more than 30 years of experience in hotel industry and foreign trade. Mr. Zhang has been president of Tianjin Amis Hotel Management Company since 2009. He acted as general delegate of Accor Hotel Group in China and president of Ibis in China from 1999 to 2008. He served as deputy general manager at China Export Commodity Base Development Corporation from 1993 to 1998. Prior to that, Mr. Zhang held senior positions at Ministry of Foreign Trade and Economic Cooperation. He was third secretary of Commercial Bureau of Chinese Embassy in Zaire from 1981 to 1985. Mr. Zhang graduated from Beijing Institute of Foreign Trade. He studied at General Department of Interpretation of European Communities in Brussels and French National School of Administration. In 2014, Mr. Zhang received medal award of Chevalier de Legion d'honneur from

French government.

Jian Shang has served as our independent director since May 2014. He has over 17 years of experience in corporate management and financial innovation. Mr. Shang has been the general manager of Hong Shang Asset Management Co., Ltd since September 2013. From 2006 to 2012, he served as chief executive officer of UBS SDIC Fund Management Company. Prior to that, he served as chief executive officer of Yin Hua Fund Management Company, deputy chief executive officer of Hua An Fund Management Company, and head of strategic planning of Shanghai Stock Exchange respectively from 2001 to 2006. Previously, he was a deputy division director of China Securities Regulatory Commission from 1997 to 2000. Mr. Shang obtained his PhD in Finance and MA in Economics from University of Connecticut, and his bachelor's degree in engineering from Shanghai Jiao Tong University.

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Sébastien Bazin has served as our director since January 2016. He is acting as the chairman and chief executive officer of Accor S.A. since 2013, where he has served as a director since January 9, 2006. Prior to that, he served as a member of the supervisory board of Accor S.A. since May 3, 2005. He is also the vice-chairman of the supervisory board of Gustave Roussy Foundation. Previously, Mr. Bazin was with Colony Capital, a private-equity firm, from 1997 to 2012, during which time he managed and participated in a large number of investments in the hospitality industry. Mr. Bazin has earned his master's degree in business management from Paris-Sorbonne University in 1985.

Gaurav Bhushan has been an alternate director to Sébastien Bazin since March 2016. He is the global chief development officer of Accor, responsible for overseeing the group's hotel development strategy worldwide. Mr. Bhushan began his career with Accor in 1995 in Australia, where he held various posts in operations and finance. From 2006 he headed the Asia Pacific development teams. He was promoted to global chief development officer role in July 2015. He has a Master of Business Administration degree from the Royal Melbourne Institute of Technology (RMIT University) and a postgraduate diploma in Applied Finance & Investments from the Securities Institute of Australia.

Min (Jenny) Zhang has served as our chief executive officer since May 2015. She also served as our president from January 2015 to May 2015, our chief financial officer from March 2008 to May 2015 and our chief strategic officer from November 2013 to January 2015. Prior to joining us, she served as the finance director of Eli Lilly (Asia) Inc., Thailand Branch and the chief financial officer of ASIMCO Casting (Beijing) Company, Ltd. She also worked previously with McKinsey & Company, Inc. as a consultant. Ms. Zhang has served on the board as a director for OneSmart International Education Group Limited since March 2018. She obtained her Master of Business Administration degree from Harvard Business School and received both master's and bachelor's degrees from the University of International Business and Economics.

Teo Nee Chuan joined us in November 2015 as Deputy Chief Financial Officer and has served as our chief financial officer since March 2016. He has more than 20 years of experience in financial areas in multinational corporations. Prior to joining us, he was chief financial officer of Rnomac International Group, the largest Volvo construction equipment distributor in China. He also served as chief financial officer and director of Operation in DDB Greater China Group and financial controller in Focus Media Group. Prior to that, Mr. Teo worked at Ernst & Young as associate director of Transaction Advisory Services in Kuala Lumpur, Toronto and Shanghai. Mr. Teo received his Bachelor of Science in Accounting and Financial Analysis degree from Warwick University, the United Kingdom. He is a Chartered Certified Accountant in the United Kingdom and a Certified Public Accountant in the United States and Hong Kong.

Hui Jin joined us in 2005 and has served as director of our Development Department, vice president and executive vice president of our Group, respectively. Mr. Jin is currently our president. Prior to joining us, Mr. Jin worked with Home Inns & Hotels Management Inc. Mr. Jin received his executive master's degree from China Europe International Business School and a Bachelor of Science degree in Psychology from the East China Normal University.

Employment Agreements

We have entered into an employment agreement with each of our named executive officers. Each of our named executive officers is employed for a specified time period, which will be automatically extended unless either we or the named executive officer gives prior notice to terminate such employment. We may terminate the employment for cause, at any time, without notice or remuneration, for certain acts, including but not limited to the conviction of a criminal offence and negligent or dishonest acts to our detriment. A named executive officer may terminate his or her employment at any time with a one-month prior written notice.

Each named executive officer has agreed to hold, both during and after the termination or expiry of his or her employment agreement, in strict confidence, and not to use, except as required in the performance of his or her duties in connection with the employment, any of our confidential information or trade secrets or the confidential or proprietary information of any third party received by us and for which we have confidential obligations. In addition, each named executive officer has agreed to be bound by non-competition restrictions. Specifically, each named executive officer has agreed not to, during his or her employment with us and for a period of two years following his or her termination with our company, be engaged as employee or in another capacity to participant directly or indirectly in any business that is in competition with ours. Each named executive officer also agrees to comply with all material applicable laws and regulations related to his or her responsibilities at our company as well as all material written corporate and business policies and procedures of our company.

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6.B. Compensation

For the fiscal year ended December 31, 2018, the aggregate cash compensation and benefits that we paid to our directors and executive officers were approximately RMB8 million (US\$1 million). No pension, retirement or similar benefits have been set aside or accrued for our executive officers or directors. We have no service contracts with any of our directors providing for benefits upon termination of employment.

Share Incentive Plans

In February 2007, our board of directors and our shareholders adopted our 2007 Global Share Plan to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentives to selected employees, directors, and consultants and to promote the success of our business. Our 2007 Global Share Plan was subsequently amended in December 2007. Ten million ordinary shares may be issued under our amended and restated 2007 Global Share Plan, or the Amended and Restated 2007 Plan.

In June 2007, our board of directors and our shareholders adopted our 2008 Global Share Plan with the same purpose as our 2007 Global Share Plan. Our 2008 Global Share Plan was subsequently amended in October 2008. Seven million ordinary shares may be issued under our amended and restated 2008 Global Share Plan, or the Amended and Restated 2008 Plan.

In September 2009, our board of directors and our shareholders adopted our 2009 Share Incentive Plan with purposes similar to our 2007 Global Share Plan and 2008 Global Share Plan. Our 2009 Share Incentive Plan was subsequently amended in October 2009, August 2010, March 2015 and May 2018. 43 million ordinary shares may be issued under our amended 2009 Share Incentive Plan, or the Amended 2009 Plan.

Plan Administration. The compensation committee administers our Amended and Restated 2007, 2008 and 2009 Plans. Our ESOP administration committee, currently comprised solely of Mr. Qi Ji, has been delegated certain authorities, among others, to grant, in its sole discretion, options, restricted stocks and restricted share units to be issued under the respective share incentive plans to any of our employees and consultants except for our directors and executive officers, and the aggregate number of shares covered by any single grant it makes shall not exceed 500,000 ordinary shares.

Types of Awards. The following briefly describes the principal features of the various awards that may be granted under our Amended and Restated 2007 and 2008 Plans.

- *Options.* Each option agreement must specify the exercise price. The exercise price of an option must not be less than 100% of the fair market value of the underlying shares on the option grant date, and a higher percentage may

be required. The term of an option granted under the Amended and Restated 2007 and 2008 Plans must not exceed ten years from the date the option is granted, and a shorter term may be required.

- *Share Purchase Rights.* A share purchase right is a right to purchase restricted stock. Each share purchase right under the Amended and Restated 2007 and 2008 Plans must be evidenced by a restricted stock purchase agreement between the purchaser and us. The purchase price will be determined by the administrator. The share purchase rights will automatically expire if not exercised by the purchaser within 30 days after the grant date.

The following briefly describes the principal features of the various awards that may be granted under our Amended 2009 Plan:

- *Options.* The purchase price per share under an option will be determined by a committee appointed by our board and set forth in the award agreement. The term of an option granted under the Amended 2009 Plan must not exceed ten years from the grant date, and a shorter term may be required.

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- *Restricted Stock and Restricted Stock Units.* An award of restricted stock is a grant of our ordinary shares subject to restrictions the committee appointed by our board may impose. A restricted stock unit is a contractual right that is denominated in our ordinary shares, each of which represents a right to receive the value of a share or a specified percentage of such value upon the terms and conditions set forth in the Amended 2009 Plan and the applicable award agreement.

- *Other Stock-based Awards.* The committee is authorized to grant other stock-based awards that are denominated or payable in or otherwise related to our ordinary shares such as stock appreciation rights and rights to dividends and dividend equivalents. Terms and conditions of such awards will be determined by the committee appointed by our board. Unless the awards are granted in substitution for outstanding awards previously granted by an entity that we acquired or combined, the value of the consideration for the ordinary shares to be purchased upon the exercise of such awards shall not be less than the fair market value of the underlying ordinary shares on the grant date.

Vesting Schedule. As of the date of this annual report, we have entered into option agreements and restricted stock award agreements respectively under our Amended and Restated 2007 and 2008 Plans and our Amended 2009 Plan. Pursuant to our typical option agreement, 50% of the options granted shall vest on the second anniversary of the vesting commencement date specified in the corresponding option agreement, and 1/48 of the options shall vest each month thereafter over the next two years on the first day of each month, subject to the optionee's continuing to provide services to us. Pursuant to our typical restricted stock award agreement, 50% of the restricted stock granted shall vest on the second anniversary of the vesting commencement date specified in the corresponding restricted stock award agreement, and 1/8 of the restricted stock shall vest each six-month period thereafter over the next two years on the last day of each six-month period, subject to the grantee's continuing to provide services to us. For certain grants, we may also apply different vesting schedules set forth in the relevant agreements between the grantees and us. For example, certain restricted stocks granted shall vest over a period of ten years in equal yearly installments.

Termination of the Amended and Restated 2007 and 2008 Plans and the Amended 2009 Plan. Our Amended and Restated 2007 Plan and our Amended and Restated 2008 Plan terminated in 2017 and 2018, respectively. Our Amended 2009 Plan will terminate in 2029. Our board of directors may amend, suspend, or terminate our Amended 2009 Plan at any time. No amendment, alteration, suspension, or termination of these plans shall materially and adversely impair the rights of any participant with respect to an outstanding award, unless mutually agreed otherwise between the participant and the administrator.

The following tables summarize options and restricted stocks that we have granted to our directors and executive officers and to other individuals as a group under our share incentive plans as of December 31, 2018.

| Name | Ordinary Shares Underlying Options Awarded | Exercise Price (US\$/Share) | Date of Grant | Date of Expiration |
|-------|--|--------------------------------|-----------------|--------------------|
| Qi Ji | 400,000 | 1.53 | October 1, 2009 | October 1, 2019 |

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| | | | | |
|------------------------------|------------|------------|-------------------|-------------------|
| | 436,348 | 2.7525 | July 17, 2012 | July 17, 2018 |
| Tong Tong Zhao | 100,000 | 1.53 | October 1, 2009 | October 1, 2019 |
| John Jiong Wu | 100,000 | 1.53 | October 1, 2009 | October 1, 2019 |
| Min (Jenny) Zhang | 1,470,000 | 1.40 | October 1, 2007 | October 1, 2017 |
| | 300,000 | 1.53 | November 20, 2009 | November 20, 2019 |
| | 207,784 | 2.7525 | July 17, 2012 | July 17, 2018 |
| Hui Jin | * | 0.50 | February 4, 2007 | February 4, 2017 |
| | * | 4.265 | March 31, 2011 | March 31, 2017 |
| | * | 5.415 | May 13, 2014 | May 13, 2020 |
| | * | 4.925 | March 31, 2015 | March 31, 2021 |
| Other individuals as a group | | | February 4, 2007 | February 4, 2017 |
| | 16,947,218 | 0.50-5.415 | April 1, 2015 | April 1, 2021 |

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| Name | Ordinary Shares Underlying Restricted Stocks Awarded | Date of Grant |
|------------------------------|--|-----------------------------------|
| Qi Ji | 200,000 | August 6, 2011 |
| | 897,880 | July 17, 2012 |
| | 1,697,187 | March 17, 2015 |
| | 1,098,224 | March 26, 2015 |
| Shangzhi Zhang | * | January 18, 2012 |
| | * | January 10, 2013 |
| | * | December 10, 2014 |
| | * | March 13, 2017 |
| Min (Jenny) Zhang | 313,944 | July 17, 2012 |
| | 73,188 | March 16, 2015 |
| | 1,697,187 | March 17, 2015 |
| | 1,098,224 | March 26, 2015 |
| Hui Jin | * | March 31, 2011 |
| | * | July 2, 2012 |
| | * | July 1, 2013 |
| | * | July 17, 2014 |
| | * | March 26, 2015 |
| Jian Shang | * | May 5, 2014 |
| Teo Nee Chuan | * | January 15, 2016 |
| Other individuals as a group | 12,235,675 | February 7, 2011 October 24, 2018 |

* Upon exercise of all options granted and vesting restricted stock granted, would beneficially own less than 1% of our outstanding ordinary shares.

6.C. Board Practices**General**

Our board of directors currently consists of seven directors and one alternative director. Under our amended and restated memorandum and articles of association, which came into effect upon our initial public offering, our board of directors shall consist of at least two directors. Our directors shall be elected by the holders of ordinary shares. There is no shareholding requirement for qualification to serve as a member of our board of directors.

Our board of directors may exercise all the powers of our company to borrow money, mortgage or charge its undertaking, property and uncalled capital, and issue debentures, debenture stock and other securities whenever money is borrowed or as security for any debt, liability or obligation of our company or of any third party.

We believe that each of Ms. Tong Tong Zhao, Mr. John Jiong Wu and Mr. Jian Shang is an independent director as that term is used in NASDAQ corporate governance rules.

Duties of Directors

Under Cayman Islands law, our directors have a duty of loyalty to act honestly in good faith with a view to our best interests. Our directors also have a duty to exercise the skill they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association.

Terms of Directors and Executive Officers

Each of our directors holds office until a successor has been duly elected and qualified. All of our executive officers are appointed by and serve at the discretion of our board of directors.

Board Committees

We have established two committees under the board of directors – the audit committee and the compensation committee. We have adopted a charter for each of the board committees. Each committee’s members and functions are described below. We currently do not plan to establish a nominations committee. As a foreign private issuer, we are permitted to follow home country corporate governance practices under Rule 5615(a)(3) of the NASDAQ Marketplace Rules. This home country practice of ours differs from Rule 5605(e) of the NASDAQ Marketplace Rules regarding implementation of a nominations committee, because there are no specific requirements under Cayman Islands law on the establishment of a nominations committee.

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Audit Committee

Our audit committee consists of two directors, namely Mr. John Jiong Wu and Mr. Jian Shang. Both directors satisfy the independence requirements of the NASDAQ Global Select Market and the SEC regulations. In addition, our board of directors has determined that Mr. Jian Shang is qualified as an audit committee financial expert within the meaning of the SEC regulations. The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

- selecting the independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by the independent auditors;
- setting clear hiring policies for employees or former employees of the independent auditors;
- reviewing with the independent auditors any audit problems or difficulties and management's response;
- reviewing and approving all proposed related-party transactions;
- discussing the annual audited financial statements with management and the independent auditors;
- discussing with management and the independent auditors major issues regarding accounting principles and financial statement presentations;
- reviewing reports prepared by management or the independent auditors relating to significant financial reporting issues and judgments;
- reviewing with management and the independent auditors related-party transactions and off-balance sheet transactions and structures;
- reviewing with management and the independent auditors the effect of regulatory and accounting initiatives and actions;

- reviewing policies with respect to risk assessment and risk management;
- reviewing our disclosure controls and procedures and internal control over financial reporting;
- timely reviewing reports from the independent auditors regarding all critical accounting policies and practices to be used by our company, all alternative treatments of financial information within GAAP that have been discussed with management and all other material written communications between the independent auditors and management;
- establishing procedures for the receipt, retention and treatment of complaints received from our employees regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- such other matters that are specifically delegated to our audit committee by our board of directors from time to time; and
- meeting separately, periodically, with management, the internal auditors and the independent auditors.

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Compensation Committee

Our compensation committee consists of Mr. John Jiong Wu and Mr. Jian Shang. Both directors satisfy the independence requirements of NASDAQ Marketplace Rules and the SEC regulations. Our compensation committee assists the board in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. The compensation committee is responsible for, among other things:

- reviewing and approving the compensation for our senior executives;
- reviewing and evaluating our executive compensation and benefits policies generally;
- reporting to our board of directors periodically;
- evaluating its own performance and reporting to our board of directors on such evaluation;
- periodically reviewing and assessing the adequacy of the compensation committee charter and recommending any proposed changes to our board of directors; and
- such other matters that are specifically delegated to the compensation committee by our board of directors from time to time.

6.D. Employees

We had 10,507, 13,525 and 15,699 employees as of December 31, 2016, 2017 and 2018, respectively. We recruit and directly train and manage all of our employees. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes. Our employees have not entered into any collective bargaining agreements.

6.E. Share Ownership

The following table sets forth information with respect to the beneficial ownership, within the meaning of Rule 13d-3 under the Exchange Act, of our ordinary shares, as of March 31, 2019 by:

- each of our directors and executive officers; and
- each person known to us to own beneficially more than 5% of our ordinary shares.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting or investment power with respect to the ordinary shares. Except as indicated below, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them.

| | Ordinary Shares Beneficially Owned(1) | |
|---|--|----------|
| | Number | % |
| Directors and Executive Officers: | | |
| Qi Ji | 100,334,185(2) | 34.0% |
| Tong Tong Zhao | 26,324,652(3) | 8.9% |
| John Jiong Wu | 8,000,000(4) | 2.7% |
| Xiaofan Wang | | |
| Shangzhi Zhang | * | * |
| Jian Shang | * | * |
| Sébastien Bazin | | |
| Gaurav Bhushan | | |
| Min (Jenny) Zhang | * | * |
| Hui Jin | * | * |
| Teo Nee Chuan | * | * |
| All Directors and Executive Officers as a Group | 109,914,771(5) | 37.3% |
| Principal Shareholders: | | |
| Winner Crown Holdings Limited | 73,144,905(6) | 24.9% |
| Accor | 29,875,543(7) | 10.2% |
| East Leader International Limited | 26,224,652(8) | 8.9% |
| Oppenheimer Funds | 29,955,154(9) | 10.2% |
| Ctrip.com International, Ltd. | 22,049,446(10) | 7.5% |
| Standard Life Aberdeen plc. | 14,959,548(11) | 5.1% |

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* Less than 1%.

(1) The number of ordinary shares outstanding in calculating the percentages for each listed person or group includes the ordinary shares underlying options held by such person or group exercisable within 60 days after March 31, 2019. Percentage of beneficial ownership of each listed person or group is based on (i) 294,316,146 ordinary shares outstanding as of March 31, 2019, and (ii) the ordinary shares underlying share options exercisable by such person within 60 days after March 31, 2019.

(2) Includes (i) 72,344,905 ordinary shares held by Winner Crown Holdings Limited, or Winner Crown, a British Virgin Islands company wholly owned by Sherman Holdings Limited, a Bahamas company, which is in turn wholly owned by Credit Suisse Trust Limited, or CS Trustee. CS Trustee acts as trustee of the Ji Family Trust, of which Mr. Qi Ji and his family members are the beneficiaries, (ii) 800,000 ADS representing 800,000 ordinary shares held by Winner Crown, charged to Morgan Stanley & Co. International plc, (iii) 400,000 ordinary shares issuable upon exercise of options held by Mr. Qi Ji that are exercisable within 60 days after March 31, 2019, (iv) 564,628 ordinary shares held by Mr. Qi Ji, and (v) 16,000,000 Restricted ADSs representing 16,000,000 ordinary shares, and 10,224,652 ordinary shares held by East Leader, over which Mr. Ji has voting power pursuant to a power of attorney dated November 27, 2014. East Leader is wholly owned by Perfect Will Holdings Limited, or Perfect Will, a British Virgin Islands company, which is in turn wholly owned by Asia Square Holdings Ltd., or Asia Square, as nominee for J. Safra Sarasin Trust Company (Singapore) Ltd., or Sarasin Trust. Sarasin Trust acts as trustee of the Tanya Trust, of which Ms. Tong Tong Zhao and her family members are the beneficiaries.

(3) Includes (i) 100,000 ordinary shares issuable upon exercise of options held by Ms. Tong Tong Zhao that are exercisable within 60 days after March 31, 2019, and (ii) 16,000,000 Restricted ADSs representing 16,000,000 ordinary shares and 10,224,652 ordinary shares held by East Leader, a British Virgin Islands company wholly owned by Perfect Will, a British Virgin Islands company, which is in turn wholly owned by Asia Square, as nominee for Sarasin Trust. Sarasin Trust acts as trustee of the Tanya Trust, of which Ms. Tong Tong Zhao and her family members are the beneficiaries. Ms. Zhao is the sole director of East Leader.

(4) Includes 8,000,000 ordinary shares held by Mr. John Jiong Wu.

(5) Includes ordinary shares and ordinary shares issuable upon exercise of all of the options that are exercisable within 60 days after March 31, 2019 held by all of our directors and executive officers as a group.

(6) Winner Crown is a British Virgin Islands company wholly owned by Sherman Holdings Limited, a Bahamas company, which is in turn wholly owned by Credit Suisse Trust Limited, or CS Trustee. CS Trustee acts as trustee of the Ji Family Trust, of which Mr. Qi Ji, our founder and executive chairman, and his family members, are the

beneficiaries. Mr. Ji is the sole director of Winner Crown. The address of Winner Crown is Vistra Corporate Service Centre, Wickhams Cay II, Road Town, Tortola, VG1110, British Virgin Islands.

(7) Includes (i) 24,895,543 ordinary shares issued to AAPC Hong Kong Limited, an indirect wholly owned subsidiary of Accor (AAPC), as reported in a Schedule 13D filed by Accor and AAPC on January 25, 2016, and (ii) 4,980,000 ADSs representing 4,980,000 ordinary shares that Accor acquired in the open market between December 14, 2014 and May 7, 2015 and transferred to AAPC on May 7, 2015. Accor is a company incorporated under the laws of France and its registered office is 82 rue Henri Farman, 92130 Issy-les-Moulineaux. AAPC is a company incorporated in Hong Kong and its registered office is Room 701, 7/F, Office Plus@Wanchai, 303 Hennessy Road, Wan Chai, Hong Kong.

(8) East Leader is a British Virgin Islands company wholly owned by Perfect Will Holdings Limited, a British Virgin Islands company, which is in turn wholly owned by Bank Sarasin Nominees (CI) Limited, as nominee for Sarasin Trust Company Guernsey Limited, or Sarasin Trust. Sarasin Trust acts as trustee of the Tanya Trust, of which Ms. Tong Tong Zhao and her family members, are the beneficiaries. Ms. Zhao is the sole director of East Leader. The address of East Leader is P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands.

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(9) Based on Amendment No. 3 to Schedule 13G filed with the SEC on March 8, 2019 by OppenheimerFunds, Inc. (the Oppenheimer Funds).

(10) Includes (i) 7,202,482 ordinary shares that Ctrip purchased from us, (ii) an aggregate of 11,646,964 of our ordinary shares that Ctrip purchased from the Chengwei Funds, CDH Courtyard Limited, the IDG Funds, the Northern Light Funds and Pinpoint Capital 2006 A Limited, and (iii) 3,200,000 ADSs representing 3,200,000 ordinary shares that Ctrip subscribed in our initial public offering. Ctrip is a Cayman Islands company and its address is 968 Jin Zhong Road, Shanghai 200335, People s Republic of China.

(11) Based on Schedule 13G filed with the SEC on February 12, 2019 by Standard Life Aberdeen plc.

As of March 31, 2019, we had 294,316,146 ordinary shares issued and outstanding. To our knowledge, we had two record shareholders in the United States. The number of beneficial owners of our ADSs in the United States is likely to be much larger than the number of record holders of our ordinary shares in the United States.

None of our existing shareholders has different voting rights from other shareholders since the closing of our initial public offering. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

ITEM 7.

MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

7.A. Major Shareholders

Please refer to Item 6. Directors, Senior Management and Employees E. Share Ownership.

7.B. Related Party Transactions

Transactions with Ctrip

We conduct transactions in the ordinary course of our business with Ctrip.com International, Ltd., or Ctrip, an entity in which Mr. Qi Ji, our founder, is a co-founder and independent director. Ctrip rendered reservation services to us to facilitate our customers in making reservations at our hotels from Ctrip s hotel booking system. In 2016, 2017 and 2018, the aggregate commission fees of our leased and owned

hotels paid to Ctrip.com for its reservation services amounted to RMB44 million, RMB77 million and RMB61 million (US\$9 million), respectively. In 2018, the lease expenses of our leased and owned hotel paid to Ctrip.com amounted to RMB18 million (US\$3 million).

In a private placement before our initial public offering in 2010, Ctrip purchased 7,202,482 ordinary shares from us and an aggregate of 11,646,964 of our ordinary shares from the Chengwei Funds, CDH Courtyard Limited, the IDG Funds, the Northern Light Funds and Pinpoint Capital 2006 A Limited at a price equal to the initial public offering price per share. The investments by Ctrip were made pursuant to transactions exempt from registration under the Securities Act. In connection with these transactions, Ctrip was granted registration rights substantially similar to those granted to certain holders of our registrable securities under our amended and restated shareholders agreement. In addition, we have granted Ctrip the right to nominate one person to serve on our board as long as Ctrip and its affiliates continuously maintain (i) at least 5% of our total outstanding ordinary shares in the three years following the closing of our initial public offering and (ii) at least 8% of our total outstanding ordinary shares thereafter. In addition, Ctrip subscribed a total of 3,200,000 ADSs in our initial public offering at the initial public offering price. The ADSs issued and sold to Ctrip are on the same terms as the other ADSs being offered in our initial public offering.

In 2016, 2017 and 2018, we provided marketing and training services to Ctrip and recorded service fees amounted to RMB13 million, RMB24 million and RMB12 million (US\$2 million), respectively.

Transaction with Sheen Star

In November 2013, We entered into an investment agreement to acquire 50% equity interest in Suzhou Kangdu Property Co., Limited, or Kangdu, a real estate company, for RMB100 million. Concurrently we entered into a property transfer agreement with Kangdu to acquire the property developed by Kangdu for a purchase price of RMB175 million. We injected RMB50 million in November 2013 and RMB30 million in January 2014 to Kangdu for the equity interest in Kangdu. In April 2014, we set up Sheen Star Group Limited, or Sheen Star, together with Mr. Qi Ji and an independent third party. We own 19.99% of the equity interest in Sheen Star and Mr. Qi Ji owns 50.01%. We then transferred our investment in Kangdu to Sheen Star for a consideration of RMB83 million, together with all of our rights and obligations under the property purchase agreement in April 2014. We had not paid any consideration to Kangdu for the property before the transfer to Sheen Star. We provided shareholder loan of RMB35 million to Sheen Star in 2016 and recognized interest income in the amount of RMB2 million in 2016. We recognized service fees from Sheen Star in the amount of RMB2 million (US\$0.3 million) in 2018.

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Transaction with Accor

In January 2016, we completed strategic alliance transactions with Accor to join forces in the Pan-China region to develop Accor brands and to form an extensive and long-term alliance with Accor. After the transaction, Accor became one of our principal shareholders and was granted a right to nominate one director to our board of directors. We recorded brand use fee, reservation and other related service fee to Accor of RMB6 million, RMB11 million and RMB18 million (US\$3 million) in 2016, 2017 and 2018, respectively. We also recognized service fee from Accor of RMB4 million, RMB8 million and RMB14 million (US\$2 million) in 2016, 2017 and 2018, respectively.

Transaction with Cjia

Cjia is an equity investee in which we held an equity interest of 20% as of December 31, 2018. We sold goods and provided IT and other services to Cjia amounted to RMB8 million and RMB30 million (US\$4 million) in 2017 and 2018, respectively. The amount of goods sold and service provided to Cjia in 2016 was immaterial.

In 2016, we sold our subsidiary Chengjia to Cjia for consideration of RMB10 million.

In 2017, we paid shareholder loan payment to Cjia amounted to RMB85 million.

In 2018, we received loan from Cjia amounted to RMB103 million (US\$15 million).

Transaction with CREATER

In 2017, we paid shareholder loan payment to CREATER amounted to RMB27.0 million and we recognized interest income of RMB10 million (US\$1 million) in 2018.

Transaction with China Hospitality JV

In 2018, we, together with TPG, formed China Hospitality JV, Ltd. (China Hospitality JV), in which we own 20% equity interest. We provided service amounted to RMB10 million (US\$1 million) to China Hospitality JV in 2018.

Employment Agreements

See Item 6. Directors, Senior Management and Employees A. Directors and Senior Management Employment Agreements for a description of the employment agreements we have entered into with our senior executive officers.

Share Incentives

See Item 6. Directors, Senior Management and Employees B. Compensation of Directors and Executive Officers Share Incentive Plans for a description of share options we have granted to our directors, officers and other individuals as a group.

7.C. Interests of Experts and Counsel

Not applicable.

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ITEM 8. FINANCIAL INFORMATION

8.A. Consolidated Statements and Other Financial Information

8.A.1. See Item 18. Financial Statements for our audited consolidated financial statements.

8.A.2. See Item 18. Financial Statements for our audited consolidated financial statements, which cover the last three financial years.

8.A.3. See page F-2 for the report of our independent registered public accounting firm.

8.A.4. Not applicable.

8.A.5. Not applicable.

8.A.6. Not applicable.

8.A.7. See Item 4. Information on the Company B. Business Overview Legal and Administrative Proceedings.

8.A.8. Dividend Policy

On December 13, 2018, we declared a cash dividend of US\$0.34 per ordinary share, or US\$0.34 per ADS. Cash dividends on our ordinary shares are paid in U.S. dollars, and the total amount of cash distributed for the dividend was approximately US\$100.1 million, which was paid in full by January 15, 2019.

On October 23, 2017, we declared a cash dividends of US\$0.16 per ordinary share, or US\$0.64 per ADS, each representing four ordinary shares. Cash dividends on our ordinary shares are paid in U.S. dollars, and the total amount of cash distributed for the dividend was approximately US\$44.7 million, which was paid in full by December 15, 2017.

We are a holding company with no material operations of our own. We conduct our operations primarily through our subsidiaries in China. As a result, our ability to pay dividends and to finance any debt we may incur depends upon dividends paid to us by our subsidiaries. If our subsidiaries or any newly formed subsidiaries incur debt on their own behalf in the future, the instruments governing their debt may restrict their ability to pay dividends to us. In addition, our subsidiaries are permitted to pay dividends to us only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. Pursuant to laws applicable to entities incorporated in the PRC, our subsidiaries in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires an annual appropriation of 10% of after-tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of its registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for specific purposes of enterprise expansion, staff bonus and welfare, and are not distributable as cash dividends. Our board of directors has complete discretion in deciding whether to distribute dividends. In 2018, PRC dividend withholding tax of RMB34 million was accrued. As of December 31, 2018, the accrued PRC dividend withholding tax liability was RMB18 million. Going forward we plan to maintain a moderate dividend distribution of approximately US\$100.0 million a year from current year net income. Other than these dividends distributions, we intend to indefinitely reinvest the remaining undistributed earnings of our PRC subsidiaries.

8.B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

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ITEM 9. *THE OFFER AND LISTING*

9.A. Offering and Listing Details

Our ADSs have been listed on the NASDAQ Global Select Market under the symbol HTHT since March 26, 2010. In 2016, 2017 and 2018, no significant trading suspensions occurred.

9.B. Plan of Distribution

Not applicable.

9.C. Markets

The principal trading market for our shares is the NASDAQ Global Select Market, on which our shares are traded in the form of ADSs.

9.D. Selling Shareholders

Not applicable.

9.E. Dilution

Not applicable.

9.F. Expenses of the Issue

Not applicable.

ITEM 10.

ADDITIONAL INFORMATION

10.A. Share Capital

Not applicable.

10.B. Memorandum and Articles of Association

We incorporate by reference into this annual report the description of our amended and restated memorandum and articles of association contained in our registration statement on Form F-1 (File No. 333-165247) originally filed with the Securities and Exchange Commission on March 5, 2010, as amended. Our shareholders adopted our amended and restated memorandum and articles of association by a special resolution on March 12, 2010 and further amended our amended and restated memorandum and articles of association by special resolutions on November 21, 2012 and December 16, 2015, respectively.

10.C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4, Information on the Company and in Item 7, Major Shareholders and Related Party Transactions or elsewhere in this annual report.

10.D. Exchange Controls

See Item 4. Information on the Company B. Business Overview Regulation Regulations on Foreign Currency Exchange.

10.E. Taxation

The following summary of the material Cayman Islands, People's Republic of China and United States federal income tax consequences of an investment in our ADSs or ordinary shares is based upon laws and relevant interpretations thereof in effect as of the date of this annual report, all of which are subject to change. This summary does not deal with all possible tax consequences relating to an investment in our ADSs or ordinary shares, such as the tax consequences under state, local and other tax laws.

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Cayman Islands Taxation

The Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to us or to holders of our ADSs or ordinary shares levied by the Government of the Cayman Islands except for stamp duties which may be applicable on instruments executed in, brought to, or produced before a court of the Cayman Islands. The Cayman Islands is a party to a double taxation treaty with the United Kingdom but otherwise is not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

PRC Taxation

PRC taxation on us

- **Enterprise Income Tax**

On March 16, 2007, the National People's Congress, the Chinese legislature, passed the *Enterprise Income Tax Law*, which was 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 PRC resident enterprises, including both foreign-invested enterprises and domestic enterprises. The EIT Law restructures China's tax preference policy under the general principle that industries and projects that are encouraged and supported by the State may enjoy tax preferential treatment. For example, enterprises classified as high and new technology enterprises strongly supported by the State are entitled to a 15% enterprise income tax rate.

The EIT Law provides that enterprises established outside of China whose de facto management bodies are located in China are considered resident enterprises. The de facto management body is defined as the organizational body that effectively exercises overall management and control over production and business operations, personnel, finance and accounting, and properties of the enterprise. 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, on April 22, 2009. Circular 82 provides certain specific criteria for determining whether the de facto management body of a PRC-controlled offshore incorporated enterprise is located in China, which include: (a) the location where senior management members responsible for an enterprise's daily operations discharge their duties; (b) the location where financial and human resource decisions are made or approved by organizations or persons; (c) the location where the major assets and corporate documents are kept; and (d) the location where more than half (inclusive) of all directors with voting rights or senior management have their habitual residence. In addition, the STA issued Public Announcement [2011] No. 45 in 2011 and Public Announcement [2014] No.9 in 2014, providing more guidance on the implementation of Circular 82 and clarifying matters including resident status determination, post-determination administration and competent tax authorities. The above-mentioned tax circulars apply only to offshore enterprises controlled by PRC enterprises or PRC enterprise groups and are not applicable to our case. But the determining criteria set forth in such tax circulars may reflect the STA's general position on how the de facto management body test should be applied in determining the tax resident status of offshore enterprises, regardless of whether they are controlled by PRC enterprises or PRC enterprise groups or by PRC or foreign individuals. 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. As such, it is still unclear if the PRC tax authorities would determine that, notwithstanding our status as the Cayman Islands holding company of our operating business in

China, we should be classified as a PRC resident enterprise.

The EIT Law imposes an enterprise income tax of 10% on dividends distributed by a 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 preferential 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 the holding company owns at least 25% equity in the PRC subsidiary and is the beneficial owner of the dividends.

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The EIT Law provides that PRC resident enterprises are generally subject to the uniform 25% enterprise income tax rate on their worldwide income. Therefore, if we are treated as a PRC resident enterprise, we will be subject to PRC income tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income and results of operations, although we would be exempt from enterprise income tax on dividends distributed from our PRC subsidiaries to us, since such dividend income distributed to a PRC resident enterprise is exempted from enterprise income tax under the EIT Law. However, if we are required under the EIT Law to pay income tax on any dividends we receive from our PRC subsidiaries, our income tax expenses will increase and the amount of dividends, if any, we may pay to our shareholders and ADS holders may be materially and adversely affected.

- Value-added Tax

On March 23, 2016, the Ministry of Finance of China and the State Administration of Taxation of China jointly issued *the Circular on the Nationwide Implementation of Pilot Program for the Collection of Value Added-Tax Instead of Business Tax*, or Circular 36, which became effective on May 1, 2016. Subsequent to the effectiveness of Circular 36, most of our PRC subsidiaries' business will be subject to value-added tax, or VAT, at a rate of 6% and they would be permitted to offset input VAT by providing valid VAT special invoices received from vendors against their VAT liability.

PRC taxation of our overseas shareholders

Under the EIT Law, PRC enterprise income tax at the rate of 10% is applicable to dividends payable to investors that are non-resident enterprises, which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends have their sources within the PRC. Similarly, any gain realized on the transfer of ADSs or ordinary shares by such investors is also subject to 10% PRC enterprise income tax if such gain is regarded as income derived from sources within the PRC. Therefore, if we are considered a PRC resident enterprise, dividends we pay to non-resident enterprise investors with respect to our ADSs or ordinary shares and the gains realized from the transfer of our ADSs or ordinary shares may be considered as income derived from sources within the PRC and be subject to PRC enterprise income tax at a rate of 10% or lower, subject to the provisions of any applicable bilateral tax treaty. The double taxation treaty between the PRC and the United States, or the Treaty, does not reduce the 10% tax rate.

Moreover, non-resident individual investors are required to pay PRC individual income tax at the rate of 20% instead of 10% enterprise income tax on dividends payable to the investors or any capital gains realized from the transfer of ADSs or ordinary shares if such gains are deemed income derived from sources within the PRC, unless there is an applicable tax treaty providing for a lower withholding tax rate. Under the PRC Individual Income Tax Law (as amended), or IITL, non-resident individual refers to an individual who has no domicile in China and does not stay in the territory of China or who has no domicile in China and has stayed in the territory of China for less than 183 days in aggregate in a calendar year. Pursuant to the IITL and its implementation rules, for purposes of the PRC capital gains tax, the taxable income will be the balance of the transfer price for the transfer of the ADSs or ordinary shares minus the original value and related taxes paid for such transfer. Therefore, if we are considered a PRC resident enterprise and dividends we pay with respect to our ADSs or ordinary shares and the gains realized from the transfer of our ADSs or ordinary shares are considered income derived from sources within the PRC by relevant competent PRC tax authorities, such dividends and gains earned by non-resident individuals may be subject to PRC individual income tax.

U.S. Federal Income Tax Considerations

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The following is a description of the material U.S. federal income tax consequences to the U.S. Holders described below of owning and disposing of ordinary shares or ADSs, but it does not purport to be a comprehensive description of all tax considerations that may be relevant to a particular person's decision to own such ordinary shares or ADSs. This discussion applies only to a U.S. Holder that holds ordinary shares or ADSs as capital assets within the meaning of Section 1221 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"). In addition, it does not describe all of the tax consequences that may be relevant in light of the U.S. Holder's particular circumstances, including alternative minimum tax consequences, the Medicare tax on net investment income, and tax consequences applicable to U.S. Holders subject to special rules, such as:

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- certain financial institutions;
- dealers or traders in securities who use a mark-to-market method of tax accounting;
- persons holding ordinary shares or ADSs as part of a straddle, wash sale, conversion transaction or integrated transaction or persons entering into a constructive sale with respect to the ordinary shares or ADSs;
- persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
- entities classified as partnerships for U.S. federal income tax purposes;
- tax-exempt entities;
- persons that own or are deemed to own ten percent or more of our stock (measured by voting power or value);
- persons who acquired our ordinary shares or ADSs pursuant to the exercise of an employee stock option or otherwise as compensation; or
- persons holding shares in connection with a trade or business conducted outside of the United States.

If an entity that is classified as a partnership for U.S. federal income tax purposes owns ordinary shares or ADSs, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. Partnerships owning ordinary shares or ADSs and partners in such partnerships should consult their tax advisers as to the particular U.S. federal income tax consequences of owning and disposing of the ordinary shares or ADSs.

This discussion is based on the Code, administrative pronouncements, judicial decisions, final, temporary and proposed Treasury regulations, all as of the date hereof, any of which is subject to change, possibly with retroactive effect. It is also based in part on representations by the depositary and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms.

A U.S. Holder is a holder who, for U.S. federal income tax purposes, is a beneficial owner of ordinary shares or ADSs and is:

- a citizen or individual resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state therein or the District of Columbia; or
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust (i) the administration of which is subject to the primary supervision of a U.S. court and which has one or more U.S. persons who have the authority to control all substantial decisions of the trust or (ii) that has otherwise elected to be treated as a U.S. person under applicable U.S. Treasury regulations.

In general, a U.S. Holder who owns ADSs will be treated as the owner of the underlying shares represented by those ADSs for U.S. federal income tax purposes. The remainder of this discussion assumes that a U.S. Holder of our ADSs will be treated as the beneficial owner of the underlying shares represented by the ADSs. Accordingly, no gain or loss will be recognized if a U.S. Holder exchanges ADSs for the underlying shares represented by those ADSs.

U.S. Holders should consult their tax advisers concerning the U.S. federal, state, local and foreign tax consequences of owning and disposing of ordinary shares or ADSs in their particular circumstances.

Table of Contents*Taxation of Distributions*

Subject to the discussion under *Passive Foreign Investment Company Rules* below, distributions paid on ordinary shares or ADSs, other than certain *pro rata* distributions of ordinary shares, will be treated as dividends to the extent paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Because we do not maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that distributions generally will be reported to U.S. Holders as dividends.

A non-corporate recipient of dividend income from a qualified foreign corporation will generally be subject to tax at a reduced U.S. federal tax rate rather than the marginal tax rates generally applicable to ordinary income provided that certain holding period and other requirements are met. A non-U.S. corporation (other than a corporation that is a PFIC for the taxable year in which the dividend is paid or the preceding taxable year) will generally be considered to be a qualified foreign corporation (a) if it is eligible for the benefits of a comprehensive tax treaty with the United States which the Secretary of Treasury of the United States determines is satisfactory for purposes of this provision and which includes an exchange of information program, or (b) with respect to any dividend it pays on stock (or ADSs in respect of such stock) which is readily tradable on an established securities market in the United States. Our ADSs are listed on the NASDAQ Global Market, and will qualify as readily tradable on an established securities market in the United States so long as they are so listed. As discussed below in *Passive Foreign Investment Company Rules*, based on our audited financial statements and relevant market and shareholder data, we believe that we should not be treated as a PFIC for U.S. federal income tax purposes with respect to the 2016, 2017 or 2018 taxable year. 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. In the event we are deemed to be a resident enterprise under the PRC Enterprise Income Tax Law, we may be eligible for the benefits of the Treaty (which the U.S. Treasury has determined is satisfactory for this purpose) and in that case we would be treated as a qualified foreign corporation with respect to dividends paid on our ordinary shares or ADSs. Since we do not expect that our ordinary shares will be listed on established securities markets, we do not believe that dividends that we pay on our ordinary shares that are not backed by ADSs currently meet the conditions required for the reduced tax rate. There can be no assurance that our ADSs will continue to be considered readily tradable on an established securities market in later years. Each non-corporate U.S. Holder is advised to consult its tax advisors regarding the availability of the reduced tax rate applicable to qualified dividend income for any dividends we pay with respect to our ADSs or ordinary shares. The amount of the dividend will be treated as foreign-source dividend income to U.S. Holders and will not be eligible for the dividends-received deduction generally available to U.S. corporations under the Code.

As discussed above, under *Item. 10. Additional Information E. Taxation PRC Taxation*, dividends we pay may be subject to PRC withholding tax. For U.S. federal income tax purposes, the amount of any dividend will include amounts withheld in respect of such PRC withholding tax. Subject to applicable limitations, some of which may vary depending upon a U.S. Holder's circumstances, PRC income taxes withheld from dividends on ordinary shares or ADSs at a rate not exceeding the rate applicable under the Treaty may be creditable against the U.S. Holder's U.S. federal income tax liability. PRC taxes withheld in excess of the rate applicable under the Treaty will not be eligible for credit against a U.S. Holder's federal income tax liability. A U.S. Holder who does not elect to claim a foreign tax credit for foreign tax withheld may instead claim a deduction, for U.S. federal income tax purposes, in respect of such withholdings, but only for a year in which such U.S. Holder elects to do so for all creditable foreign income taxes. The rules governing foreign tax credits are complex, and U.S. Holders should consult their tax advisers regarding the creditability of foreign taxes in their particular circumstances.

Dividends will be included in a U.S. Holder's income on the date of the U.S. Holder's, or in the case of ADSs, the depositary's, actual or constructive receipt of the dividend. The amount of any dividend income paid in RMB will be the U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. Holder should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. Holder may have foreign currency gain or loss, which would be U.S. source ordinary gain or loss, if the dividend is converted into U.S. dollars after the date of receipt.

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Sale or Other Disposition of Ordinary Shares or ADSs

For U.S. federal income tax purposes, gain or loss realized on the sale or other disposition of ordinary shares or ADSs will be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder held the ordinary shares or ADSs for more than one year. The amount of the gain or loss will equal the difference between the U.S. Holder's tax basis in the ordinary shares or ADSs disposed of and the amount realized on the disposition, in each case as determined in U.S. dollars. The deductibility of capital losses is subject to limitations.

As described in Taxation PRC Taxation PRC taxation on us, if we were deemed to be a tax resident enterprise under PRC tax law, gains from dispositions of our ordinary shares or ADSs may be subject to PRC withholding tax. In that case, a U.S. Holder's amount realized would include the gross amount of the proceeds of the sale or disposition before deduction of the PRC tax. Although any such gain of a U.S. Holder would generally be characterized as U.S.-source income, a U.S. Holder that is eligible for the benefits of the Treaty may be entitled to elect to treat the gain as foreign-source income for foreign tax credit purposes. U.S. Holders should consult their tax advisers regarding their eligibility for benefits under the Treaty and the creditability of any PRC tax on dispositions with respect to their particular circumstances.

Passive Foreign Investment Company Rules

We do not believe we were a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our 2018 taxable year. However, because PFIC status depends on the composition of our income and assets and the market value of our assets from time to time, as well as our market capitalization at the close of each quarter, there can be no assurance that we will not be a PFIC for any taxable year. While we have no reason to believe we will be or become a PFIC in the current or future taxable years, 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 IRS 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.

If we were a PFIC for any taxable year during which a U.S. Holder held ordinary shares or ADSs, gain recognized by a U.S. Holder on a sale or other disposition (including certain pledges) of the ordinary shares or ADSs would be allocated ratably over the U.S. Holder's holding period for the ordinary shares or ADSs. The amounts allocated to the taxable year of the sale or other disposition and to any year before we became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for that taxable year, and an interest charge would be imposed on the amount allocated to that taxable year. Further, to the extent that any distribution received by a U.S. Holder on its ordinary shares or ADSs exceeds 125% of the average of the annual distributions on the ordinary shares or ADSs received during the preceding three years or the U.S. Holder's holding period, whichever is shorter, that distribution would be subject to taxation in the same manner as gain, described immediately above.

If we were a PFIC, a U.S. Holder could, if certain conditions are met, make a mark-to-market election with respect to our ADSs that would result in tax treatment different from the general tax treatment for PFICs described above. Because a mark-to-market election cannot be made for any lower-tier PFICs that a PFIC may own, a U.S. Holder who makes a mark-to-market election with respect to our ADSs will generally continue to be subject to the foregoing rules with respect to such U.S. Holder's indirect interest in any investments held by us that are treated as an equity interest in a PFIC for U.S. federal income tax purposes. If a U.S. Holder were to make an effective mark-to-market election for the first year that we are a PFIC, the holder generally would recognize as ordinary income any excess of the fair market value of the ADSs at the end of each taxable year over its adjusted tax basis, and would recognize an ordinary loss in respect of any excess of the adjusted tax basis of the ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of income previously included as a result of the mark-to-market election). If a U.S. Holder makes the election, the holder's tax basis in the ADSs will be adjusted to reflect these income or

loss amounts. If we were a PFIC, it is unclear whether our ordinary shares would be treated as marketable stock eligible for the mark-to-market election. Any gain recognized on the sale or other disposition of ADSs in a year when we are a PFIC would be treated as ordinary income and any loss would be treated as an ordinary loss (but only to the extent of the net amount of income previously included as a result of the mark-to-market election).

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A timely election to treat us as a qualified electing fund under Section 1295 of the Code would also result in alternative treatment from the general treatment for PFICs described above (which alternative treatment could, in certain circumstances, mitigate the adverse tax consequences of holding shares in a PFIC). U.S. Holders should be aware, however, that we do not intend to satisfy record-keeping and other requirements or provide relevant information that would permit U.S. Holders to make qualified electing fund elections if we were a PFIC.

In addition, if we were a PFIC, the favorable rates discussed above with respect to dividends paid to certain non-corporate U.S. Holders would not apply. Furthermore, if we were a PFIC for any taxable year during which a U.S. Holder held ordinary shares or ADSs, such U.S. Holder may be required to file a report (IRS Form 8621 or other relevant form) containing such information as the U.S. Treasury may require. U.S. Holders should consult their tax advisers regarding the potential application of the PFIC rules, including potential reporting obligations.

Specified Foreign Financial Assets

Certain U.S. Holders that own specified foreign financial assets with an aggregate value in excess of USD 50,000 are generally required to file an information statement along with their tax returns, currently on Form 8938, with respect to such assets. Specified foreign financial assets include any financial accounts held at a non-U.S. financial institution, as well as securities issued by a non-U.S. issuer that are not held in accounts maintained by financial institutions. Higher reporting thresholds apply to certain individuals living abroad and to certain married individuals. Regulations extend this reporting requirement to certain entities that are treated as formed or availed of to hold direct or indirect interests in specified foreign financial assets based on certain objective criteria. U.S. Holders who fail to report the required information could be subject to substantial penalties. Prospective investors should consult their own tax advisers concerning the application of these rules to their investment in ADSs or ordinary shares, including the application of the rules to their particular circumstances.

Information Reporting and Backup Withholding

Dividend payments with respect to ADSs or ordinary shares and proceeds from the sale or exchange of ADSs or ordinary shares may be subject to information reporting to the Internal Revenue Service and possible U.S. backup withholding. Backup withholding will not apply, however, to a U.S. Holder who furnishes a correct taxpayer identification number and makes any other required certification or who is otherwise exempt from backup withholding. U.S. Holders who are required to establish their exempt status generally must provide such certification on Internal Revenue Service Form W-9. U.S. Holders should consult their tax advisers regarding the application of the U.S. information reporting and backup withholding rules.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability, and you may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information.

10.F. Dividends and Paying Agents

Not applicable.

10.G. Statement by Experts

Not applicable.

10.H. Documents on Display

We are subject to the periodic reporting and other informational requirements of the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the SEC. Specifically, we are required to file annually a Form 20-F no later than four months after the close of each fiscal year, which is December 31. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the Securities and Exchange Commission at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. The public may obtain information regarding the Washington, D.C. Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

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10.I. Subsidiary Information

Not applicable.

ITEM 11. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest Rate Risk

Our exposure to interest rate risk primarily relates to the interest rates for our outstanding debt and the interest income generated by excess cash invested in liquid investments with original maturities of three months or less. We do not rely on derivative financial instruments to manage our interest risk exposure. Interest-earning instruments carry a degree of interest rate risk.

We have not been exposed to material risks due to changes in interest rates. However, our future interest income and interest expense may be different from expected due to changes in market interest rates.

Foreign Exchange Risk

Substantially all of our revenues and most of our expenses are denominated in RMB. Our exposure to foreign exchange risk primarily relates to cash and cash equivalents and loans denominated in U.S. dollars, and our investment in equity securities of Accor denominated in Euro. Although in general, our exposure to foreign exchange risks should be limited, the value of your investment in our ADSs will be affected by the foreign exchange rate between U.S. dollars and RMB because the value of our business is effectively denominated in RMB, while the ADSs will be traded in U.S. dollars.

The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of RMB into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy caused the Renminbi to appreciate by more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. Since June 2010, the RMB has fluctuated against the U.S. dollar, at times significantly and unpredictably. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the RMB and the U.S. dollar in the future. To the extent we hold assets denominated in U.S. dollars, any appreciation of the RMB against the U.S. dollar could result in a change to our statement of operations and a reduction in the value of our U.S. dollar denominated assets. On the other hand, a decline in the value of the RMB against the U.S. dollar could reduce the U.S. dollar equivalent amounts of our financial results, the value of your investment in our company and the dividends we may pay in the future, if any, all of which may have a material adverse effect on the prices of ADSs. By way of example, assuming we had converted a U.S. dollar denominated cash balance of US\$1.0 million as of December 31, 2018 into Renminbi at the exchange rate of US\$1.00 for RMB6.8755, such cash balance would have been approximately RMB6.9 million (US\$1.0

million). Assuming a 1.0% depreciation of the RMB against the U.S. dollar, such cash balance would have increased to RMB6.8 million (US\$1.0 million) as of December 31, 2018.

Inflation

Since our inception, inflation in China has not materially impacted our results of operations. According to the National Bureau of Statistics of China, consumer price index in China increased by 2.0%, 1.6% and 2.1 in 2016, 2017 and 2018, respectively. Although we have not been materially affected by inflation in the past, we may be affected if China experiences higher rates of inflation in the future.

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ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

12.A. Debt Securities

Not applicable.

12.B. Warrants and Rights

Not applicable.

12.C. Other Securities

Not applicable.

12.D. American Depositary Shares

Fees and Charges Our ADS holders May Have to Pay

An ADS holder will be required to pay the following service fees to the depositary, Citibank, N.A.:

| Service | Fees |
|--|--------------------------------|
| • Issuance of ADSs | Up to U.S. 5¢ per ADS issued |
| • Cancellation of ADSs | Up to U.S. 5¢ per ADS canceled |
| • Distribution of cash dividends or other cash distributions | Up to U.S. 5¢ per ADS held |
| • Distribution of ADSs pursuant to stock dividends, free stock distributions or exercise of rights | Up to U.S. 5¢ per ADS held |
| • Distribution of securities other than ADSs or rights to purchase additional ADSs | Up to U.S. 5¢ per ADS held |
| • Depositary Services | |

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Up to U.S. 5¢ per ADS held on the applicable record date(s) established by the Depositary (U.S. 2¢ per ADS for the year of 2018)

An ADS holder will also be responsible to pay certain fees and expenses incurred by the depositary and certain taxes and governmental charges such as:

- Fees for the transfer and registration of ordinary shares charged by the registrar and transfer agent for the ordinary shares in the Cayman Islands (i.e., upon deposit and withdrawal of ordinary shares).
- Expenses incurred for converting foreign currency into U.S. dollars.
- Expenses for cable, telex and fax transmissions and for delivery of securities.
- Taxes and duties upon the transfer of securities (i.e., when ordinary shares are deposited or withdrawn from deposit).
- Fees and expenses incurred in connection with the delivery or servicing of ordinary shares on deposit.

Depositary fees payable upon the issuance and cancellation of ADSs are typically paid to the depositary banks by the brokers (on behalf of their clients) receiving the newly issued ADSs from the depositary banks and by the brokers (on behalf of their clients) delivering the ADSs to the depositary banks for cancellation. The brokers in turn charge these fees to their clients. Depositary fees payable in connection with distributions of cash or securities to ADS holders and the depositary services fee are charged by the depositary banks to the holders of record of ADSs as of the applicable ADS record date.

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The depositary fees payable for cash distributions are generally deducted from the cash being distributed. In the case of distributions other than cash (i.e., stock dividend, rights), the depositary banks charge the applicable fee to the ADS record date holders concurrent with the distribution. In the case of ADSs registered in the name of the investor (whether certificated or uncertificated in direct registration), the depositary banks send invoices to the applicable record date ADS holders. In the case of ADSs held in brokerage and custodian accounts (via The Depository Trust Company (DTC)), the depositary banks generally collect its fees through the systems provided by DTC (whose nominee is the registered holder of the ADSs held in DTC) from the brokers and custodians holding ADSs in their DTC accounts. The brokers and custodians who hold their clients' ADSs in DTC accounts in turn charge their clients' accounts the amount of the fees paid to the depositary banks.

In the event of refusal to pay the depositary fees, the depositary may, under the terms of the deposit agreement, refuse the requested service until payment is received or may set off the amount of the depositary fees from any distribution to be made to the ADS holder.

The fees and charges an ADS holder may be required to pay may vary over time and may be changed by us and by the depositary. An ADS holder will receive prior notice of such changes.

Fees and Other Payments Made by the Depositary to Us

The depositary may reimburse us for certain expenses incurred by us in respect of the ADR program established pursuant to the deposit agreement, by making available a portion of the depositary fees charged in respect of the ADR program or otherwise, upon such terms and conditions as we and the depositary may agree from time to time. For the year ended December 31, 2018, we have received a total of RMB5 million (US\$1 million) from the depositary as reimbursement for our expenses incurred in connection with investor relationship programs related to the ADS program.

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PART II

ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES*

None of these events occurred in any of the years ended December 31, 2016, 2017 and 2018.

ITEM 14. *MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS*

In April 2018, we effected a change of the ratio of our ADSs to ordinary shares from one (1) ADS representing four (4) ordinary shares to one (1) ADS representing one (1) ordinary share.

ITEM 15. *CONTROLS AND PROCEDURES*

Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, has performed an evaluation of the effectiveness of our disclosure controls and procedures within the meaning of Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of the end of the period covered by this annual report. Based on such evaluation, our management has concluded that, as of the end of the period covered by this annual report, our disclosure controls and procedures were effective.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with generally accepted accounting principles and includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles and that a company's receipts and expenditures are being made only in accordance with authorizations of a company's management and directors and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on the consolidated financial statements.

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Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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. As required by Section 404 of the Sarbanes-Oxley Act and related rules as promulgated by the SEC, our management assessed the effectiveness of the internal control over financial reporting as of December 31, 2018 using criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2018.

Attestation Report of the Registered Public Accounting Firm

The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by Deloitte Touche Tohmatsu Certified Public Accountants LLP, an independent registered public accounting firm. The attestation report issued by Deloitte Touche Tohmatsu Certified Public Accountants LLP can be found on page F-3 of this annual report on Form 20-F.

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Changes in Internal Control over Financial Reporting

We had implemented internal controls to ensure that we have adequately evaluated the contracts and properly assessed the impact of the new accounting standards related to revenue recognition on our financial statements to facilitate the adoption on January 1, 2018. There were no significant changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting due to the adoption of the new standards during 2018.

ITEM 16A. *AUDIT COMMITTEE FINANCIAL EXPERT*

Our board of directors has determined that Mr. Jian Shang is an audit committee financial expert, as that term is defined in Item 16A(b) of Form 20-F, and is independent for the purposes of Rule 5605(a)(2) of the NASDAQ Marketplace Rules, or the NASDAQ Rules, and Rule 10A-3 under the Exchange Act.

ITEM 16B. *CODE OF ETHICS*

Our board of directors adopted a code of business conduct and ethics on January 27, 2010 that applies to our directors, officers, employees and agents, including certain provisions that specifically apply to our executive officers and any other persons who perform similar functions for us. We have filed our code of business conduct and ethics as an exhibit to our registration statement on Form F-1 (File No. 333-165247) originally filed with the Securities and Exchange Commission on March 5, 2010, as amended. Our code of business conduct and ethics is publicly available on our website at <http://ir.huazhu.com/>.

ITEM 16C. *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

Deloitte Touche Tohmatsu Certified Public Accountants LLP, or Deloitte, our independent registered public accounting firm, began serving as our auditor in August 2009.

Our audit committee is responsible for the oversight of Deloitte's work. The policy of our audit committee is to pre-approve all audit and non-audit services provided by Deloitte, including audit services, audit-related services, tax services and other services, other than those for *de minimis* services which are approved by the audit committee prior to the completion of the audit.

We paid the following fees for professional services to Deloitte for the years ended December 31, 2017 and 2018.

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| | Year Ended December 31, | |
|-----------------------|-------------------------|--------------|
| | 2017 US\$ | 2018 US\$ |
| | (In millions) | |
| Audit Fees(1) | 1.2 | 1.2 |
| Audit-Related Fees(2) | 0.5 | |
| Tax Fees(3) | | 0 |
| Total | 1.7 | 1.2 |

Note: (1) Audit Fees. This category includes the aggregate fees billed for the professional services rendered by our principal auditors for assurance and related services. Our 2017 and 2018 audit fees mainly include the audit of our annual financial statements, the services provided in connection with our compliance with the Sarbanes-Oxley Act, or services that are normally provided by the accountant in connection with statutory and regulatory filings.

(2) Audit-Related Fees. This category includes the aggregate fees billed for the professional services rendered by our principal auditors for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under Audit Fees. Audit-Related Fees in 2017 was to support the issuance of convertible senior notes and the agreed-upon procedures related to our acquisition transaction.

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(3) Tax Fees. This category includes the aggregate fees billed for the professional services rendered by our principal auditors for tax compliance and tax advice.

ITEM 16D. *EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES*

Not applicable.

ITEM 16E. *PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS*

None.

ITEM 16F. *CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT*

Not applicable.

ITEM 16G. *CORPORATE GOVERNANCE*

We are a foreign private issuer (as such term is defined in Rule 3b-4 under the Exchange Act), and our ADSs are listed on the NASDAQ Global Select Market. The NASDAQ rules provide that foreign private issuers may follow home country practice in lieu of the corporate governance requirements of the NASDAQ Stock Market LLC, subject to certain exceptions and requirements and except to the extent that such exemptions would be contrary to U.S. federal securities laws and regulations. The significant differences between our corporate governance practices and those followed by domestic companies under the NASDAQ rules are summarized as follows:

- We follow home country practice that permits our board of directors not to have a majority of independent directors in lieu of complying with Rule 5605(b)(1) of the NASDAQ.
- We follow home country practice that permits our independent directors not to hold regularly scheduled meetings at which only independent directors are present in lieu of complying with Rule 5605(b)(2) of the NASDAQ.

- We follow home country practice that permits our board of directors not to implement a nominations committee, in lieu of complying with Rule 5605(e) of the NASDAQ Rules that requires the implementation of a nominations committee.
- We follow home country practice that permits our audit committee may comprise two directors rather than three required under Rule 5605(c)(2) of the NASDAQ.
- We followed home country practice that permits us not to disclose in our annual report or website the material terms of all agreements or arrangements between any director, nominee for director and any person or entity other than our company relating to compensation or other payment in connection with that person's candidacy or services as a director of our company, in lieu of complying with Rule 5250(b)(3) of the NASDAQ.

Other than the above, we have followed and intend to continue to follow the applicable corporate governance standards under the NASDAQ rules.

In accordance with Rule 5250(d)(1) of the NASDAQ, we will post this annual report on Form 20-F on our company website at <http://ir.huazhu.com>.

ITEM 16H. *MINE SAFETY DISCLOSURE*

Not applicable.

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PART III

ITEM 17. FINANCIAL STATEMENTS

We have elected to provide financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

Our consolidated financial statements are included at the end of this annual report.

ITEM 19. EXHIBITS

| Exhibit Number | Description of Document |
|-------------------|--|
| 1.1 | <u>Amended and Restated Memorandum and Articles of Association of the Registrant. (Incorporated by reference to Exhibits 3.2 from the Amendment No. 1 to our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 12, 2010.)</u> |
| 1.2 | <u>Amendment to the Amended and Restated Articles of Association of the Registrant, adopted by the shareholders of the Registrant on November 21, 2012. (Incorporated by reference to Exhibit 1.2 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 23, 2013.)</u> |
| 1.3 | <u>Amendment to the Amended and Restated Articles of Association of the Registrant, adopted by the shareholders of the Registrant on December 16, 2015 and effective on January 25, 2016. (Incorporated by reference to Exhibit 1.3 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2016.)</u> |
| 2.1 | <u>Registrant's Specimen American Depositary Receipt (Incorporated by reference to Form 424b3 (file no. 333-165402) filed with the Securities and Exchange Commission on April 25, 2018.)</u> |
| 2.2* | <u>Registrant's Specimen Certificate for Ordinary Shares</u> |
| 2.3 | <u>Form of Deposit Agreement among the Registrant, the Depository and all Holders and Beneficial Owners of the American Depositary Shares issued thereunder. (Incorporated by reference to Exhibits 4.3 from the Amendment No. 1 to our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 12, 2010.)</u> |
| 4.1 | <u>Amended and Restated 2007 Global Share Plan, amended and restated as of December 12, 2007. (Incorporated by reference to Exhibit 10.1 from our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 5, 2010.)</u> |
| 4.2 | |

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Amended and Restated 2008 Global Share Plan, amended and restated as of October 31, 2008. (Incorporated by reference to Exhibit 10.2 from our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 5, 2010.)

- 4.3 Amended and Restated 2009 Share Incentive Plan, amended and restated as of October 1, 2009. (Incorporated by reference to Exhibit 10.3 from our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 5, 2010.)
- 4.4 Amendment to the Amended and Restated 2009 Share Incentive Plan, amended as of August 26, 2010. (Incorporated by reference to Exhibit 99.2 from our report on Form 6-K (file no. 333-34656) filed with the Securities and Exchange Commission on July 15, 2010.)
- 4.5 Amendment to the Amended and Restated 2009 Share Incentive Plan, amended as of March 26, 2015. (Incorporated by reference to Exhibit 99.2 from our report on Form 6-K filed with the Securities and Exchange Commission on March 27, 2015.)

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- 4.6 Form of Indemnification Agreement with the Registrant's Directors. (Incorporated by reference to Exhibit 10.4 from our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 5, 2010.)
- 4.7 English translation of the Form of Employment Agreement between the Registrant and Executive Officers of the Registrant. (Incorporated by reference to Exhibit 4.6 from our annual report on Form 20-F (File No. 001-34656) filed with the Securities and Exchange Commission on April 12, 2012.)
- 4.8 English translation of the Fixed Assets Loan Contract between the Industrial and Commercial Bank of China and HanTing Xingkong (Shanghai) Hotel Management Co., Ltd., dated March 2, 2012. (Incorporated by reference to Exhibit 4.10 from our annual report on Form 20-F (File No. 001-34656) filed with the Securities and Exchange Commission on April 12, 2012.)
- 4.9 English translation of the Facility Agreement between China Merchants Bank and HanTing Xingkong (Shanghai) Hotel Management Co., Ltd., dated September 25, 2012. (Incorporated by reference to Exhibit 4.8 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 23, 2013.)
- 4.10 Subscription Agreement between the Registrant and Ctrip.com International, Ltd., dated March 12, 2010. (Incorporated by reference to Exhibit 10.9 from the Amendment No. 1 to our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 12, 2010.)
- 4.11 Investor and Registration Rights Agreement between the Registrant and Ctrip.com International, Ltd., dated March 12, 2010. (Incorporated by reference to Exhibit 10.10 from the Amendment No. 1 to our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 12, 2010.)
- 4.12 Share Purchase Agreement by and between China Lodging Holdings (HK) Limited and C-Travel International Limited, dated April 15, 2012. (Incorporated by reference to Exhibit 4.11 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 23, 2013.)
- 4.13 English translation of Entrusted Loan agreement by and between HanTing Xingkong (Shanghai) Hotel Management Co., Ltd, Ctrip Computer Technology Co., Ltd and China Construction Bank Corporation, dated December 19, 2013 (Incorporated by reference to Exhibit 4.12 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 17, 2014.)
- 4.14 English translation of Letter of Guarantee by and between Ctrip.com International, Ltd. and the Registrant, dated December 19, 2013 (Incorporated by reference to Exhibit 4.13 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 17, 2014.)
- 4.15 Master Purchase Agreement among the Registrant, AAPC Singapore Pte. Ltd. and AAPC Hong Kong Limited dated December 14, 2014 (Incorporated by reference to Exhibit 4.15 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 17, 2015.)
- 4.16 Securities Purchase Agreement between the Registrant and AAPC Hong Kong Limited, dated December 14, 2014 (Incorporated by reference to Exhibit 4.16 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 17, 2015.)
- 4.17 Amended and Restated Master Purchase Agreement among the Registrant, AAPC Singapore Pte. Ltd. and AAPC Hong Kong Limited, dated as of December 14, 2014 and amended and restated as of January 25, 2016 (Incorporated by reference to Exhibit 4.17 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2016.)
- 4.18 Amended and Restated Securities Purchase Agreement between the Registrant and AAPC Hong Kong Limited, dated as of December 14, 2014 and amended and restated as of dated January 25, 2016 (Incorporated by reference to Exhibit 4.18 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2016.)

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- 4.19 Investor and Registration Rights Agreement between the Registrant and AAPC Hong Kong Limited, dated January 25, 2016 (Incorporated by reference to Exhibit 4.19 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2016.)
- 4.20 Amended and Restated Non-Competition Agreement between Accor S.A., AAPC Hong Kong Limited, the Registrant and Qi Ji dated January 25, 2016 (Incorporated by reference to Exhibit 99.B to the Schedule 13D filed by Accor S.A. and AAPC Hong Kong Limited with the Securities and Exchange Commission on February 8, 2016.) (Incorporated by reference to Exhibit 99.B to the Schedule 13D filed by Accor S.A. and AAPC Hong Kong Limited with the Securities and Exchange Commission on February 5, 2016.)
- 4.21 Share Purchase Agreement related to Crystal Orange Hotel Holdings Limited between the Vendors named therein and the Registrant dated February 25, 2017 (Incorporated by reference to Exhibit 4.21 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 21, 2017.)
- 4.22 Underwriting Agreement among the Registrant, Deutsche Bank AG, London Branch and Deutsche Bank Securities Inc. dated October 26, 2017 (Incorporated by reference to Exhibit 1.1 on Form 6-K filed with the Securities and Exchange Commission on October 31, 2017.)
- 4.23 ADS Lending Agreement between the Registrant and Deutsche Bank AG, London Branch dated October 26, 2017 (Incorporated by reference to Exhibit 99.1 on Form 6-K filed with the Securities and Exchange Commission on October 31, 2017.)
- 4.24 Purchase Agreement between the Registrant and Deutsche Bank Securities Inc. dated October 26, 2017 (Incorporated by reference to Exhibit 4.24 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.25 Base Capped Call Transaction Confirmation between the Registrant and Deutsche Bank AG, London Branch dated October 26, 2017 (Incorporated by reference to Exhibit 4.25 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.26 Base Capped Call Transaction Confirmation between the Registrant and JPMorgan Chase Bank, National Association dated October 26, 2017 (Incorporated by reference to Exhibit 4.26 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.27 Base Capped Call Transaction Confirmation between the Registrant and Morgan Stanley & Co. LLC dated October 26, 2017 (Incorporated by reference to Exhibit 4.27 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.28 Additional Capped Call Transaction Confirmation between the Registrant and Deutsche Bank AG, London Branch dated October 31, 2017 (Incorporated by reference to Exhibit 4.28 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.29 Additional Capped Call Transaction Confirmation between the Registrant and JPMorgan Chase Bank, National Association dated October 31, 2017 (Incorporated by reference to Exhibit 4.29 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.30 Additional Capped Call Transaction Confirmation between the Registrant and Morgan Stanley & Co. LLC dated October 31, 2017 (Incorporated by reference to Exhibit 4.30 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 4.31 Indenture between the Registrant and Wilmington Trust, National Association dated November 3, 2017 (Incorporated by reference to Exhibit 4.31 from our annual report on Form 20-F filed with the Securities and Exchange Commission on April 20, 2018)
- 8.1* Subsidiaries of the Registrant.
- 11.1 Code of Business Conduct and Ethics of the Registrant (Incorporated by reference to Exhibit 99.1 from our Registration Statement on Form F-1 (file no. 333-165247) filed with the Securities and Exchange Commission on March 5, 2010.)

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- 12.1* Certification of Min (Jenny) Zhang, Chief Executive Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 12.2* Certification of Teo Nee Chuan, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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| | |
|----------|--|
| 13.1** | <u>Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 15.1* | <u>Consent of Deloitte Touche Tohmatsu Certified Public Accountants LLP, Independent Registered Public Accounting Firm.</u> |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed with this Annual Report on Form 20-F.

** Furnished with this Annual Report on Form 20-F.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

HUAZHU GROUP LIMITED

| | | |
|-----|-----------------------|-------------------------|
| By: | /s/ Min (Jenny) Zhang | |
| | Name: | Min (Jenny) Zhang |
| | Title: | Chief Executive Officer |

Date: April 19, 2019

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HUAZHU GROUP LIMITED

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DECEMBER 31, 2016, 2017 AND 2018**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF HUAZHU GROUP LIMITED

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Huazhu Group Limited and its subsidiaries and variable interest entities (the Group) as of December 31, 2018 and 2017, the related consolidated statements of comprehensive income, shareholder's equity, and cash flows, for each of the three years in the period ended December 31, 2018, and the related notes and schedules (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of Huazhu Group Limited and its subsidiaries and variable interest entities as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the PCAOB), the Group's internal control over financial reporting as of December 31, 2018, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 19, 2019, expressed an unqualified opinion on the Group's internal control over financial reporting.

Adoption of New Accounting Standards

As discussed in Note 2 to the financial statements, the Group has changed its method of accounting for revenue from contracts with customers upon full retrospective adoption of Accounting Standards Update (ASU) 2014-09 *Revenue from Contracts with Customers (Topic 606)* and related ASUs, and its method of accounting for financial instruments upon modified retrospective adoption of ASU 2016-01, *Financial Instruments*, on January 1, 2018.

Convenience Translation

Our audits also comprehended the translation of Renminbi amounts into United States dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 2. Such United States dollar amounts are presented solely for the convenience of readers in the United States of America.

Basis for Opinion

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These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP

Shanghai, China

April 19, 2019

We have served as the Company's auditor since 2009.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF HUAZHU GROUP LIMITED

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Huazhu Group Limited and its subsidiaries and variable interest entities (the Group) as of December 31, 2018 based on criteria established in *Internal Control – Integrated Framework (2013 framework)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria established in *Internal Control – Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the PCAOB), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2018 of the Group and our report dated April 19, 2019 expressed an unqualified opinion on those financial statements and financial statement schedules and included an explanatory paragraph regarding the adoption of new accounting standards, and convenience translation of Renminbi amounts into United States dollar amounts.

As described in the Management's Report on Internal Controls over Financial Reporting, management excluded from its assessment the internal control over financial reporting at Blossom Hill Hotel Investment Management(Kunshan) Co., Ltd. (Blossom Hill), which was acquired on August 31, 2018, whose financial statements constitute 2.6% and 1.2% of net and total assets, respectively, 0.3% of revenues and (2.0%) of net income of the consolidated financial statement amounts as of and for the year ended December 31, 2018. Accordingly, our audit did not include the internal control over financial reporting at Blossom Hill.

Basis for Opinion

The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating

the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Deloitte Touche Tohmatsu Certified Public Accountants LLP

Shanghai, China

April 19, 2019

Table of Contents**HUAZHU GROUP LIMITED****CONSOLIDATED BALANCE SHEETS****(Renminbi in millions, except share and per share data, unless otherwise stated)**

| | 2017 | As of December 31, 2018 | 2018 US\$ million (Note 2) |
|---|--------|----------------------------|----------------------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | 3,475 | 4,262 | 620 |
| Restricted cash | 481 | 622 | 91 |
| Short-term investments measured at fair value | 130 | 89 | 13 |
| Accounts receivable, net of allowance of RMB10 and RMB17 as of December 31, 2017 and 2018, respectively | 163 | 195 | 28 |
| Loan receivables | 381 | 94 | 14 |
| Amounts due from related parties | 118 | 176 | 25 |
| Prepaid rent | 660 | 955 | 139 |
| Inventories | 24 | 41 | 6 |
| Other current assets | 329 | 540 | 78 |
| Total current assets | 5,761 | 6,974 | 1,014 |
| Property and equipment, net | 4,523 | 5,018 | 730 |
| Intangible assets, net | 1,644 | 1,834 | 267 |
| Land use rights, net | 140 | 220 | 32 |
| Long-term investments, including marketable securities measured at fair value of RMB907 and RMB4,022 as of December 31, 2017 and 2018, respectively | 2,362 | 6,152 | 895 |
| Goodwill | 2,265 | 2,630 | 383 |
| Loan receivables | 42 | 189 | 27 |
| Other assets | 365 | 471 | 69 |
| Deferred tax assets | 406 | 505 | 73 |
| Total assets | 17,508 | 23,993 | 3,490 |
| LIABILITIES AND EQUITY | | | |
| Current liabilities: | | | |
| Short-term debt | 131 | 948 | 138 |
| Accounts payable | 766 | 890 | 129 |
| Amounts due to related parties | 37 | 75 | 11 |
| Salary and welfare payables | 427 | 521 | 76 |
| Deferred revenue | 943 | 1,005 | 146 |
| Accrued expenses and other current liabilities | 1,249 | 1,607 | 233 |
| Dividends payable | | 658 | 96 |
| Income tax payable | 218 | 265 | 39 |
| Total current liabilities | 3,771 | 5,969 | 868 |
| Long-term debt | 4,922 | 8,812 | 1,282 |
| Deferred rent | 1,380 | 1,507 | 219 |
| Deferred revenue | 398 | 458 | 67 |
| Other long-term liabilities | 381 | 453 | 66 |
| Deferred tax liabilities | 422 | 475 | 69 |
| Total liabilities | 11,274 | 17,674 | 2,571 |

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Commitments and contingencies (Note 20)

Equity:

| | | | |
|--|--------|--------|-------|
| Ordinary shares (US\$0.0001 par value per share; 8,000,000,000 shares authorized; 294,040,234 and 296,597,888 shares issued as of December 31, 2017 and 2018, and 280,518,358 and 283,076,012 shares outstanding as of December 31, 2017 and 2018, respectively) | 0 | 0 | 0 |
| Treasury shares (3,096,764 and 3,096,764 shares as of December 31 2017 and 2018, respectively) | (107) | (107) | (16) |
| Additional paid-in capital | 3,624 | 3,713 | 540 |
| Retained earnings | 2,513 | 2,610 | 380 |
| Accumulated other comprehensive income (loss) | 168 | (42) | (6) |
| Total Huazhu Group Limited shareholders' equity | 6,198 | 6,174 | 898 |
| Noncontrolling interest | 36 | 145 | 21 |
| Total equity | 6,234 | 6,319 | 919 |
| Total liabilities and equity | 17,508 | 23,993 | 3,490 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HUAZHU GROUP LIMITED****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Renminbi in millions, except share and per share data, unless otherwise stated)**

| | 2016 | Years Ended December 31, | | 2018 |
|---|-------|--------------------------|--------|--------------------------|
| | | 2017 | 2018 | US\$ million (Note 2) |
| Revenues: | | | | |
| Leased and owned hotels | 5,239 | 6,338 | 7,470 | 1,087 |
| Manachised and franchised hotels | 1,419 | 1,851 | 2,527 | 368 |
| Others | 31 | 40 | 66 | 9 |
| Total revenues | 6,689 | 8,229 | 10,063 | 1,464 |
| Less: Business tax and related taxes | (116) | | | |
| Net revenues | 6,573 | 8,229 | 10,063 | 1,464 |
| Operating costs and expenses: | | | | |
| Hotel operating costs | 4,934 | 5,675 | 6,476 | 942 |
| Other operating costs | 8 | 17 | 15 | 2 |
| Selling and marketing expenses | 209 | 285 | 348 | 50 |
| General and administrative expenses | 492 | 691 | 851 | 124 |
| Pre-opening expenses | 72 | 206 | 255 | 37 |
| Total operating costs and expenses | 5,715 | 6,874 | 7,945 | 1,155 |
| Other operating (expenses) income, net | (17) | 71 | 226 | 32 |
| Income from operations | 841 | 1,426 | 2,344 | 341 |
| Interest income | 67 | 113 | 148 | 21 |
| Interest expense | 11 | 87 | 244 | 35 |
| Other income, net | 134 | 128 | 203 | 30 |
| Unrealized gains (losses) from fair value changes of equity securities | | 35 | (914) | (133) |
| Foreign exchange gain (loss) | 16 | (18) | (144) | (21) |
| Income before income taxes | 1,047 | 1,597 | 1,393 | 203 |
| Income tax expense | 279 | 357 | 569 | 83 |
| Income (loss) from equity method investments | 6 | (12) | (97) | (14) |
| Net income | 774 | 1,228 | 727 | 106 |
| Less: net (loss) income attributable to noncontrolling interest | (8) | (0) | 11 | 2 |
| Net income attributable to Huazhu Group Limited | 782 | 1,228 | 716 | 104 |
| Other comprehensive income | | | | |
| Unrealized securities holding gains, net of tax of (2), (8) and nil for 2016, 2017 and 2018, respectively | 16 | 1 | | |
| Reclassification of realized gains to net income, net of tax | (68) | (5) | | |
| Foreign currency translation adjustments, net of tax of nil for 2016, 2017 and 2018, respectively | (13) | 177 | (169) | (25) |
| Comprehensive income | 709 | 1,401 | 558 | 81 |
| Less: comprehensive (loss) income attributable to the noncontrolling interest | (8) | (0) | 11 | 2 |
| Comprehensive income attributable to Huazhu Group Limited | 717 | 1,401 | 547 | 79 |

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| | | | | |
|--|-------------|-------------|-------------|-------------|
| Earnings per share: | | | | |
| Basic | 2.84 | 4.40 | 2.54 | 0.37 |
| Diluted | 2.76 | 4.21 | 2.49 | 0.36 |
| Weighted average number of shares used in computation: | | | | |
| Basic | 275,139,070 | 279,272,140 | 281,717,485 | 281,717,485 |
| Diluted | 282,889,494 | 293,073,978 | 303,605,809 | 303,605,809 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HUAZHU GROUP LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****(Renminbi in millions, except share data, unless otherwise stated)**

| | Ordinary Shares | | Treasury Shares | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Noncontrolling Interest | Total Equity | |
|--|------------------|-----------------------|-----------------|-----------------|-------------------------------|-------------------|---|----------------------------|--------------|------|
| | Issued shares | Outstanding shares | Amount | Share Amount | | | | | | |
| Balance at January 1, 2016 | 253,978,323 | 250,881,559 | 0 | 3,096,764 | (107) | 2,470 | 1,007 | 60 | 11 | 3,4 |
| Cumulative effect of the adoption of ASU 2014-09 | | | | | | | (209) | | | (20 |
| Issuance of ordinary shares upon exercise of options and vesting of restricted stocks | 2,505,264 | 2,505,264 | 0 | | | 11 | | | | 1 |
| Issuance of ordinary shares for acquisition | 24,895,543 | 24,895,543 | 0 | | | 1,143 | | | | 1,14 |
| Share-based compensation | | | | | | 55 | | | | 5 |
| Excess tax benefit from share-based compensation | | | | | | 19 | | | | 19 |
| Net income | | | | | | | 782 | | (8) | 77 |
| Unrealized securities holding gains, net of tax | | | | | | | | 16 | | 16 |
| Reclassification of realized gains to net income, net of tax | | | | | | | | (68) | | (68 |
| Dividends paid to noncontrolling interest holders | | | | | | | | | (4) | (4) |
| Capital contribution from noncontrolling interest holders | | | | | | 1 | | | 45 | 46 |
| Dispose of noncontrolling interest for deconsolidation | | | | | | | | | (27) | (27) |
| Foreign currency translation adjustments | | | | | | | | (13) | | (13) |
| Balance at December 31, 2016 | 281,379,130 | 278,282,366 | 0 | 3,096,764 | (107) | 3,699 | 1,580 | (5) | 17 | 5,1 |

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| | | | | | | | | | | |
|---|-------------|-------------|---|-----------|-------|-------|-------|------|----|-------|
| Issuance of ordinary shares upon exercise of options and vesting of restricted stocks | 2,235,992 | 2,235,992 | 0 | | | 9 | | | | |
| Share-based compensation | | | | | | 66 | | | | |
| Issuance of ordinary shares under ADS lending arrangement | 10,425,112 | | 0 | | | | | | | |
| Capped Call options in connection with issuance of convertible senior notes | | | | | | (177) | | | | (1) |
| ADS lending arrangement in connection with issuance of convertible senior notes | | | | | | 27 | | | | 2 |
| Noncontrolling interest recognized in connection with acquisitions | | | | | | | | | 4 | |
| Net income | | | | | | 1,228 | | | 0 | 1,228 |
| Cash dividends paid | | | | | | (295) | | | | (295) |
| Unrealized securities holding gains, net of tax | | | | | | | | 1 | | |
| Reclassification of realized gains to net income, net of tax | | | | | | | | (5) | | |
| Dividends paid to noncontrolling interest holders | | | | | | | | | | (3) |
| Capital contribution from noncontrolling interest holders | | | | | | | | | | 26 |
| Noncontrolling interest recognized from partial disposal | | | | | | | | | | 0 |
| Acquisition of noncontrolling interest | | | | | | 0 | | | | (4) |
| Disposal of noncontrolling interest for deconsolidation | | | | | | | | | | (4) |
| Foreign currency translation adjustments | | | | | | | | 177 | | 177 |
| Balance at December 31, 2017 | 294,040,234 | 280,518,358 | 0 | 3,096,764 | (107) | 3,624 | 2,513 | 168 | 36 | 6,228 |
| Cumulative effect of the | | | | | | | 41 | (41) | | |

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| | | | | | | | | | | |
|---|-------------|-------------|---|-----------|-------|-------|-------|-------|------|-------|
| adoption of ASU 2016-01 | | | | | | | | | | |
| Issuance of ordinary shares upon exercise of options and vesting of restricted stocks | 2,557,654 | 2,557,654 | 0 | | | 14 | | | | |
| Share-based compensation | | | | | | 83 | | | | |
| Net income | | | | | | | 716 | | 11 | 72 |
| Cash dividends declared | | | | | | | (660) | | | (66) |
| Dividends paid to noncontrolling interest holders | | | | | | | | | (5) | |
| Capital contribution from noncontrolling interest holders | | | | | | | | | 29 | 29 |
| Noncontrolling interest recognized in connection with acquisitions | | | | | | | | | 150 | 150 |
| Acquisition of noncontrolling interest | | | | | | (8) | | | (76) | (84) |
| Foreign currency translation adjustments | | | | | | | | (169) | | (169) |
| Balance at December 31, 2018 | 296,597,888 | 283,076,012 | 0 | 3,096,764 | (107) | 3,713 | 2,610 | (42) | 145 | 6,312 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HUAZHU GROUP LIMITED****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Renminbi in millions, unless otherwise stated)**

| | 2016 | Years Ended December 31, | | 2018 |
|---|-------|--------------------------|---------|----------------------------------|
| | | 2017 | 2018 | 2018 US\$ million (Note 2) |
| Operating activities: | | | | |
| Net income | 774 | 1,228 | 727 | 106 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Share-based compensation | 55 | 66 | 83 | 12 |
| Depreciation and amortization | 695 | 789 | 891 | 130 |
| Amortization of issuance cost of convertible senior notes | | 3 | 28 | 4 |
| Deferred taxes | 26 | (79) | (91) | (13) |
| Bad debt expenses | 1 | 2 | 10 | 1 |
| Deferred rent | 103 | 209 | 140 | 20 |
| Loss from disposal of property and equipment | 9 | 13 | 0 | 0 |
| Impairment loss | 154 | 169 | 35 | 5 |
| Loss (Income) from equity method investments, net of dividends | (6) | 12 | 157 | 23 |
| Investment (income) loss | (117) | (160) | 1,009 | 147 |
| Changes in operating assets and liabilities, net of effect of acquisitions: | | | | |
| Accounts receivable | (46) | 4 | (36) | (5) |
| Prepaid rent | (25) | (189) | (283) | (41) |
| Inventories | 4 | 3 | (14) | (2) |
| Amounts due from related parties | (9) | (31) | (32) | (5) |
| Other current assets | (41) | (76) | (56) | (8) |
| Other assets | (5) | (54) | (32) | (5) |
| Accounts payable | 59 | 8 | 11 | 2 |
| Amounts due to related parties | 7 | 3 | 38 | 6 |
| Salary and welfare payables | 61 | 133 | 91 | 13 |
| Deferred revenue | 27 | 26 | 114 | 17 |
| Accrued expenses and other current liabilities | 225 | 278 | 140 | 20 |
| Income tax payable | 64 | 45 | 48 | 7 |
| Other long-term liabilities | 51 | 51 | 71 | 10 |
| Net cash provided by operating activities | 2,066 | 2,453 | 3,049 | 444 |
| Investing activities: | | | | |
| Purchases of property and equipment for hotels in operation and headquarters | (296) | (405) | (568) | (82) |
| Purchases of property and equipment for hotels under development | (207) | (414) | (547) | (80) |
| Purchases of intangibles | (14) | (8) | (4) | (1) |
| Purchases of land use rights | | | (76) | (11) |
| Amount received as a result of government zoning | 2 | 3 | 7 | 1 |
| Acquisitions, net of cash received | 132 | (3,746) | (496) | (72) |
| Proceeds from disposal of subsidiary and branch, net of cash disposed | (21) | 14 | 8 | 1 |
| Purchase of long-term investments | (293) | (1,328) | (4,959) | (721) |
| Proceeds from maturity/sale and return of long-term investments | 15 | 128 | 177 | 26 |
| Payment for shareholder loan to equity investees | (39) | (113) | (7) | (1) |
| Collection of shareholder loan from equity investees | 9 | 120 | | |
| Purchases of short-term investments | | (96) | | |
| Proceeds from maturity/sale of short-term investments | 526 | | | |
| Payment for the origination of loan receivables | (36) | (446) | (313) | (46) |
| Proceeds from collection of loan receivables | 46 | 56 | 433 | 63 |
| Net cash (used in) investing activities | (176) | (6,235) | (6,345) | (923) |
| Financing activities: | | | | |

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| | | | | |
|---|-------|---------|-------|-------|
| Net proceeds from issuance of ordinary shares upon exercise of options | 12 | 9 | 14 | 2 |
| Proceeds from short-term bank borrowings | 282 | 137 | 928 | 135 |
| Repayment of short-term bank borrowings | (333) | (295) | (128) | (19) |
| Proceeds from long-term bank borrowings | | 3,633 | 4,275 | 622 |
| Repayment of long-term bank borrowings | | (1,651) | (799) | (116) |
| Funds advanced from noncontrolling interest holders | 12 | 84 | 36 | 5 |
| Repayment of funds advanced from noncontrolling interest holders | (1) | (9) | (8) | (1) |
| Acquisitions of noncontrolling interest | (4) | (4) | (84) | (12) |
| Proceeds from amounts due to related parties | | | 103 | 15 |
| Repayment of amounts due to related parties | | | (113) | (16) |
| Contribution from noncontrolling interest holders | 46 | 26 | 29 | 4 |
| Dividends paid to noncontrolling interest holders | (4) | (3) | (5) | (1) |
| Dividends paid | (276) | (306) | | |
| Proceeds from issuance of convertible senior notes, net of issuance cost and capped call option | | 2,925 | | |
| Direct financing costs paid | | (10) | | |
| Proceeds from ADS lending | | 0 | | |
| Net cash (used in) provided by financing activities | (266) | 4,536 | 4,248 | 618 |
| Effect of exchange rate changes on cash and cash equivalents, and restricted cash | 14 | (34) | (24) | (3) |
| Net increase in cash and cash equivalents, and restricted cash | 1,638 | 720 | 928 | 136 |
| Cash, cash equivalents and restricted cash at the beginning of the year | 1,598 | 3,236 | 3,956 | 575 |
| Cash, cash equivalents and restricted cash at the end of the year | 3,236 | 3,956 | 4,884 | 711 |
| Supplemental disclosure of cash flow information: | | | | |
| Interest paid, net of amounts capitalized | 9 | 187 | 239 | 35 |
| Income taxes paid | 184 | 380 | 613 | 89 |
| Supplemental schedule of non-cash investing and financing activities: | | | | |
| Purchases of property and equipment included in payables | 453 | 613 | 688 | 100 |
| Consideration payable for business acquisition | 173 | 118 | 40 | 6 |
| Purchase of intangible assets included in payables | 7 | 6 | 5 | 1 |
| Reimbursement of government zoning included in receivables | 3 | 2 | | |
| Issuance of ordinary shares for acquisition of AccorHotels (Note 3) | 1,144 | | | |
| Cash dividends declared in payables | | | 658 | 96 |

The accompanying notes are an integral part of these consolidated financial statements.

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HUAZHU GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2016, 2017 and 2018
(Renminbi in thousands, except share data and per share data,
unless otherwise stated)

1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Huazhu Group Limited (the Company) was incorporated in the Cayman Islands under the laws of the Cayman Islands on January 4, 2007. The principal business activities of the Company and its subsidiaries and variable interest entities (the Group) are to develop leased and owned, manachised and franchised hotels under the Joya Hotel, Crystal Orange, Blossom Hill, Manxin Hotel, Orange Hotel Select, Orange Hotel Hotel, Starway Hotel, HanTing Hotel, HanTing Premium, Elan Hotel and Hi Inn brands in the People's Republic of China (PRC). The also has the rights as master franchisee for Mercure, Ibis and Ibis Styles, and co-development rights for Grand Mercure and Novotel, in Pan-China region.

Leased and owned hotels

The Group leases hotel properties from property owners or purchases properties directly and is responsible for all aspects of hotel operations and management, including hiring, training and supervising the managers and employees required to operate the hotels. In addition, the Group is responsible for hotel development and customization to conform to the standards of the Group brands at the beginning of the lease or the construction, as well as repairs and maintenance, operating expenses and management of properties over the term of the lease or the land and building certificate.

Under the lease arrangements, the Group typically receives rental holidays of two to six months and pays rent on a quarterly or biannual basis. Rent is typically subject to the fixed escalations of three to five percent every three to five years. The Group recognizes rental expense on a straight-line basis over the lease term.

As of December 31, 2017 and 2018, the Group had 671 and 699 leased and owned hotels in operation, respectively.

Manachised and franchised hotels

Typically the Group enters into certain franchise and management arrangements with franchisees for which the Group is responsible for providing branding, quality assurance, training, reservation, hiring and appointing of the hotel general manager and various other support

services relating to the hotel renovation and operation. Those hotels are classified as managed hotels. Under typical franchise and management agreements, the franchisee is required to pay an initial franchise fee and ongoing franchise and management service fees, the majority of which are equal to a certain percentage of the revenues of the hotel. The franchisee is responsible for the costs of hotel development, renovation and the costs of its operations. The term of the franchise and management agreements are typically eight to ten years and are renewable upon mutual agreement between the Group and the franchisee. The Group also has some franchised hotels in which cases the Group does not provide a hotel general manager. As of December 31, 2017 and 2018, the Group had 2,874 and 3,309 managed hotels in operation and 201 and 222 franchised hotels in operation, respectively.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

Basis of presentation

The consolidated financial statements of the Group have been prepared in accordance with the accounting principles generally accepted in the United States of America (US GAAP).

Basis of consolidation

The consolidated financial statements include the financial statements of the Company, its majority-owned subsidiaries and consolidated variable interest entities (the VIEs). All intercompany transactions and balances are eliminated on consolidation.

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Variable Interest Entities

The Group evaluates the need to consolidate certain variable interest entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support.

The Company is deemed as the primary beneficiary of and consolidates variable interest entities when the Company has the power to direct the activities that most significantly impact the economic success of the entities and effectively assumes the obligation to absorb losses and has the rights to receive benefits that are potentially significant to the entities.

As of December 31, 2017 and 2018, the Group consolidated two and six entities under VIE model, and the assets and liabilities of the consolidated VIEs are immaterial to the Group's consolidated financial statements.

The Group evaluates its business activities and arrangements with the entities that operate the managed and franchised hotels and the funds that it serves as general partner or fund manager to identify potential variable interest entities. Generally, these entities that operate the managed and franchised hotels qualify for the business scope exception, therefore consolidation is not appropriate under the variable interest entity consolidation guidance. For the disclosure of significant non-consolidated variable interest entities, see Note 7 Investments.

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Group bases its estimates on historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Significant accounting estimates reflected in the Group's consolidated financial statements include the useful lives and impairment of property and equipment and intangible assets, valuation allowance of deferred tax assets, purchase price allocation, impairment of goodwill, fair value measurement and impairment of investments, share-based compensation, estimates involved in the accounting for its customer loyalty program, and contingent liabilities.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and demand deposits, which are unrestricted as to withdrawal and use, and which have original maturities of three months or less when purchased.

Restricted cash

Restricted cash mainly represents deposits used as security against borrowings and deposits restricted due to contract disputes or lawsuit.

Investments

Investments represent equity-method investments, equity investments with readily determinable fair values, equity investments without readily determinable fair values and available-for-sale debt securities.

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The Group accounts for equity investment in entities with significant influence under equity-method accounting. Under this method, the Group's pro rata share of income (loss) from investment is recognized in the consolidated statements of comprehensive income. Dividends received reduce the carrying amount of the investment. When the Group's share of loss in an equity-method investee equals or exceeds its carrying value of the investment in that entity, the Group continues to report its share of equity method losses in the statements of comprehensive income to the extent and as an adjustment to the carrying amount of its other investments in the investee. Equity-method investment is reviewed for impairment by assessing if the decline in market value of the investment below the carrying value is other-than-temporary. In making this determination, factors are evaluated in determining whether a loss in value should be recognized. These include consideration of the intent and ability of the Group to hold investment and the ability of the investee to sustain an earnings capacity, justifying the carrying amount of the investment. Impairment losses are recognized in other expense when a decline in value is deemed to be other-than-temporary.

Investments in equity securities that have readily determinable fair values (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value, with unrealized gains and losses from fair value changes recognized in net income in the consolidated statements of comprehensive income.

Investments in equity securities without readily determinable fair values are measured at cost minus impairment adjusted by observable price changes in orderly transactions for the identical or a similar investment of the same issuer. These investments are measured at fair value on a nonrecurring basis when there are events or changes in circumstances that may have a significant adverse effect. An impairment loss is recognized in the consolidated statements of comprehensive income equal to the amount by which the carrying value exceeds the fair value of the investment. Prior to the fiscal year of 2018, these investments were accounted for using the cost method of accounting, measured at cost less other-than-temporary impairment.

Debt securities that the company has no intent to hold till maturity or may sell the security in response to the changes in economic conditions are classified as available-for-sale debt securities. Available-for-sale debt securities are reported at fair value, with unrealized gains and losses (other than impairment losses) recognized in accumulated other comprehensive income or loss. Realized gains and losses on debt securities are recognized in the net income in the consolidated statements of comprehensive income. The Group monitors its investments for other-than-temporary impairment by considering factors including, but not limited to, current economic and market conditions, the operating performance of the companies including current earnings trends and other company-specific information.

As a result of the impairment analysis, the Group recorded an impairment of RMB3, nil and nil in 2016, 2017 and 2018, respectively.

Accounts receivable, net of allowance

Accounts receivable mainly consist of franchise fee receivables, amounts due from corporate customers, travel agents, hotel guests and credit card receivables, which are recognized and carried at the original invoice amount less an allowance for doubtful accounts. The Group establishes an allowance for doubtful accounts primarily based on the age of the receivables and factors surrounding the credit risk of specific customers.

Loan receivables

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Loan receivables are measured at amortized cost with interest accrued based on the contract rate. The Group classified loan receivables as long-term or short-term investments according to their contractual maturity or expected holding time. The Group evaluates the credit risk associated with the loans, and estimates the cash flow expected to be collected over the life of loans on an individual basis based on the Group's past experiences, the borrowers' financial position, their financial performance and their ability to continue to generate sufficient cash flows. A valuation allowance will be established for the loans unable to collect. No valuation allowance has been recorded in 2016, 2017 or 2018 based on the result of the assessment. The Group entered into entrusted loan agreements with certain franchisees with the typical terms to be two to three years and annual interest rates ranging from 8.0% to 8.5%, and with other un-related third-parties with the annual interest rates ranging from 6% to 12%.

Table of Contents***Inventories***

Inventories mainly consist of small appliances, bedding and daily consumables. Small appliances and bedding for new hotels opened are stated at cost, less accumulated amortization, and are amortized over their estimated useful lives, generally one year, from the time they are put into use. Daily consumables and beddings replacement are expensed when used.

Property and equipment, net

Property and equipment, net are stated at cost less accumulated depreciation and amortization. The renovations, betterments and interest cost incurred during construction are capitalized. Depreciation and amortization of property and equipment is provided using the straight line method over their expected useful lives. The expected useful lives are as follows:

| | |
|-----------------------------------|---|
| Leasehold improvements | Shorter of the lease term or their estimated useful lives |
| Buildings | 20-40 years |
| Furniture, fixtures and equipment | 3-10 years |
| Motor vehicles | 5 years |

Construction in progress represents leasehold improvements and property under construction or being installed and is stated at cost. Cost comprises original cost of property and equipment, installation, construction and other direct costs. Construction in progress is transferred to leasehold improvements and depreciation commences when the asset is ready for its intended use.

Expenditures for repairs and maintenance are expensed as incurred. Gain or loss on disposal of property and equipment, if any, is recognized in the consolidated statements of comprehensive income as the difference between the net sales proceeds and the carrying amount of the underlying asset.

Intangible assets, net and unfavorable lease

Intangible assets consist primarily of brand name, master brand agreement, non-compete agreements, franchise agreements and favorable leases acquired in business combinations and purchased software. Intangible assets acquired through business combinations are recognized as assets separate from goodwill if they satisfy either the contractual-legal or separability criterion. Intangible assets, including brand name, master brand agreement, non-compete agreements, franchise agreements and favorable lease agreements acquired from business combination are recognized and measured at fair value upon acquisition.

Non-compete agreements, franchise agreements and favorable lease agreements are amortized over the expected useful life, remaining franchise contract terms and remaining operating lease terms respectively. Unfavorable lease agreements from business combination transactions are recognized as other long-term liabilities and are amortized over the remaining operating lease terms. Purchased software is stated at cost less accumulated amortization.

Brand name is considered to have an indefinite life. Master brand agreement, acquired in Accor acquisition (Note 3), granted the Group certain franchise rights with initial term of 70 years, and can be renewed without substantial obstacles. As a result, the useful life is determined to be indefinite. The Group evaluates the brand name and master brand agreement each reporting period to determine whether events and circumstances continue to support an indefinite useful life. Impairment is tested annually or more frequently if events or changes in circumstances indicate that it might be impaired. The Group measures the impairment by comparing the fair value of brand name and master brand agreement with its carrying amount. If the carrying amount of brand name and master brand agreement exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The Group measures the fair value of the brand name under the relief-from-royalty method, the master brand agreement under the multi-period excess earnings method. Management performs its annual brand name and master brand agreement impairment test on November 30.

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Land use rights

Land use rights, which are all located in PRC, are recorded at cost and amortized on a straight-line basis over the remaining term of the land certificates, between 30 to 50 years. Amortization expense of land use rights for the years ended December 31, 2016, 2017 and 2018 amounted to RMB4, RMB5 and RMB5, respectively.

Impairment of long-lived assets

The Group evaluates its long-lived assets and finite lived intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, the Group measures impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Group recognizes an impairment loss equal to the difference between the carrying amount and fair value of these assets.

The Group performed a recoverability test of its long-lived assets associated with certain hotels due to the continued underperformance relative to the projected operating results, of which the carrying amount of the property and equipment exceed the future undiscounted net cash flows, and recognized an impairment loss of RMB151, RMB169 and RMB35 during the years ended December 31, 2016, 2017 and 2018, respectively.

Fair value of the property and equipment was determined by the Group based on the income approach using the discounted cash flow associated with the underlying assets, which incorporated certain assumptions including projected hotels' revenue, growth rates and projected operating costs based on current economic condition, expectation of management and projected trends of current operating results.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the identifiable assets less liabilities acquired.

Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. The Group completes a two-step goodwill impairment test. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. A reporting unit is identified as a component for which discrete financial information is available and is regularly reviewed by management. All the acquired business has been migrated to the Group's business, and the Group's management regularly reviews operation data including industrial metrics of revenue per available room, occupancy rate, and number of hotels by scale/brand, rather than discrete financial information for the purpose of performance evaluation and resource allocation at brand level. The Company concluded that it had only one reporting unit, and therefore the goodwill impairment testing was performed on consolidation level. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for

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purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized in general and administrative expenses for any excess in the carrying value of goodwill over the implied fair value of goodwill. Management performs its annual goodwill impairment test on November 30.

The Group had not recognized any goodwill impairment for years ended December 31, 2016, 2017 and 2018.

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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, the Group receives 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 the Group s 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 forms 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 recognized as revenue over the term of the franchise contract. The Group does not consider this advance consideration to include a significant financing component, since it is used to protect the Group 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.

Reimbursements for hotel manager fees, which cover the manachised hotel managers payroll, social welfare benefits and certain other out-of-pocket expenses that the Group incurs on behalf of the manachised hotels. The reimbursements are recognized over time within revenues for the reimbursement of costs incurred on behalf of manachised hotels.

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Other Revenues

Other revenues are derived from activities other than the operation of hotel businesses, which mainly include revenues from Hua Zhu mall and the provision of IT products and services to hotels. Revenues from Hua Zhu mall are commissions charged from suppliers for goods sold through the platform and are recognized upon delivery of goods to end customers when its suppliers' obligation is fulfilled. Revenues from IT products are recognized when goods are delivered and revenues from IT services are recognized when services are rendered.

Loyalty Program

Under the loyalty program the Group administers, members earn loyalty points that can be redeemed for future products and services. Points earned by loyalty program members represent a material right to free or discounted goods or services in the future. The loyalty program has one performance obligation that consists of marketing and managing the program and arranging for award redemptions by members. The Group is responsible for arranging for the redemption of points, but the Group does not directly fulfill the redemption obligation except at leased and owned hotels. Therefore, the Group is the agent with respect to this performance obligation for manachised and franchised hotels, and is the principal with respect to leased and owned hotels.

For leased and owned hotels, a portion of the leased and owned revenues is deferred until a member redeems points. The amount of revenue the Group recognize upon point redemption is impacted by the estimate of the breakage for points that members will never redeem in the Group's owned and leased hotels.

For manachised and franchised hotels, the portion of revenue deferred by manachised and franchised hotels are collected by the Group which will be refunded upon redemption of points at manachised and franchised hotels. The estimated breakage for points earned in manachised and franchised hotels are recognized as manachised and franchised revenue for each period. The Group estimates breakage based on the Group's historical experience and expectations of future member behavior and will true up the estimated breakage at end of each period.

Membership fees from the Group's customer loyalty program are earned and recognized on a straight-line basis over the expected membership duration of the different membership levels. Such duration is estimated based on the Group's and management's experience and is adjusted on a periodic basis to reflect changes in membership retention. The membership duration is estimated to be two to five years which reflects the expected membership retention. Revenues recognized from membership fees were RMB145, RMB160 and RMB192 for the years ended December 31, 2016, 2017 and 2018, respectively, which amount were included in revenues from leased and owned hotel or revenues from manachised and franchised hotels depending on the type of hotels the membership was sold at.

Contract Balances

The Group's payments from customers are based on the billing terms established in contracts. Customer billings are classified as accounts receivable when the Group's right to consideration is unconditional. If the right to consideration is conditional on future performance under the

contract, the balance is classified as a contract asset. Payments received in advance of performance under the contract are classified as current or non-current contract liabilities on the Group's consolidated balance sheets and are recognized as revenue as the Group performs under the contract.

PRC Value-Added Taxes and surcharges

Starting from May 2016, the accommodation services of the Group are subject to 6% of Value-Added Taxes.

The Group is subject to education surtax and urban maintenance and construction tax, on the services provided in the PRC.

Advertising and promotional expenses

Advertising related expenses, including promotion expenses and production costs of marketing materials, are charged to the consolidated statements of comprehensive income as incurred, and amounted to RMB65, RMB91 and RMB103 for the years ended December 31, 2016, 2017 and 2018, respectively.

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Government grants

Government grants represent cash received by the Group in the PRC from local governments as incentives for investing in certain local districts, and are typically granted based on the amount of investments the Group made as well as income generated by the Group in such districts. Such subsidies allow the Group full discretion to utilize the funds and are used by the Group for general corporate purposes. The local governments have final discretion as to whether the Group has met all criteria to be entitled to the subsidies. Normally, the Group does not receive written confirmation from local governments indicating the approval of the cash subsidy before cash is received, and therefore cash subsidies are recognized when received and when all the conditions for their receipts have been satisfied. Government grants recognized were RMB83, RMB55 and RMB106 for the years ended December 31, 2016, 2017 and 2018, respectively, which were recorded as other operating income.

Leases

A lease of which substantially all the benefits and risks incidental to ownership remain with the lessor is classified as an operating lease. All leases of the Group are currently classified as operating leases. When a lease contains rent holidays or requires fixed escalations of the minimum lease payments, the Group records the total rental expense on a straight-line basis over the initial lease term and the difference between the straight-line rental expense and cash payment under the lease is recorded as deferred rent. As of December 31, 2017 and 2018, deferred rent of RMB50 and RMB71 were recorded as other current liabilities and RMB1,380 and RMB1,507 were recorded as long-term liabilities, respectively.

Income taxes

Current income taxes are provided for in accordance with the relevant statutory tax laws and regulations.

Deferred income taxes are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Net operating losses are carried forward and credited by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of the Group, it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized.

Foreign currency translation

The reporting currency of the Group is the Renminbi (RMB). The functional currency of the Company is the United States dollar (US dollar). Monetary assets and liabilities denominated in currencies other than the functional currency are translated into functional currency at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the functional currency during the year are converted into the functional currency at the applicable rates of exchange prevailing on the day transactions occurred. Transaction gains and losses are recognized in the statements of comprehensive income.

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Assets and liabilities are translated into RMB at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of comprehensive income.

The financial records of the Group's subsidiaries are maintained in local currencies, which are the functional currencies.

Comprehensive income

Comprehensive income includes all changes in equity except for those resulting from investments by owners and distributions to owners and is comprised of net income, foreign-currency translation adjustments and unrealized securities holding gains (losses) recognized before the adoption of ASU No. 2016-01.

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Concentration of credit risk

Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents, restricted cash, short-term and long-term investments, loan receivables, amount due from related parties and accounts receivable.

All of the Group's cash and cash equivalents and restricted cash are held with financial institutions that Group management believes to be high credit quality. In addition, the Group's investment policy limits its exposure to concentrations of credit risk and the Group's short-term and long-term investments consist of equity investments in listing and private companies. The Group's loan receivables are lent to entities with high credit quality. The Group conducts credit evaluations on its group and agency customers and generally does not require collateral or other security from such customers. The Group periodically evaluates the creditworthiness of the existing customers in determining an allowance for doubtful accounts primarily based upon the age of the receivables and factors surrounding the credit risk of specific customers.

Fair value

The Group defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

The established fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs may be used to measure fair value include:

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The Group's financial instruments include cash and cash equivalent, restricted cash, loan receivables current and non-current portion, receivables, payables, short-term debts, long-term debts. The carrying amounts of these short-term financial instruments approximates their fair value due to their short-term nature. The long-term debts and long-term loan receivables approximate their fair values, because the bearing interest rate

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approximates market interest rate, and market interest rates have not fluctuated significantly since the commencement of loan contracts signed.

When available, the Group uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Group measures fair value using valuation techniques that use, when possible, current market-based or independently sourced market parameters, such as interest rates.

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As of December 31, 2017 and 2018, information about inputs into the fair value measurements of the Group's assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to their initial recognition is as follows:

| Years Ended December 31, | Description | Fair Value | Fair Value Measurements at Reporting Date Using | | |
|-----------------------------|--|------------|---|---|--|
| | | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| 2017 | Equity securities with readily determinable fair value | 1,037 | 1,037 | | |
| 2017 | Available-for-sale debt securities | 346 | | 346 | |
| 2018 | Equity securities with readily determinable fair value | 4,111 | 4,111 | | |
| 2018 | Available-for-sale debt securities | 320 | | 320 | |

The following table presents the Group's assets measured at fair value on a non-recurring basis for the years ended December 31, 2016, 2017 and 2018:

| Years Ended December 31, | Description | Fair Value for Years Ended December 31 | Fair Value Measurements at Reporting Date Using | | | Total Loss for the Year |
|-----------------------------|---------------------------|--|---|---|--|-------------------------------|
| | | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| 2016 | Property and equipment | 21 | | | 21 | 151 |
| 2016 | Equity-method investments | | | | | 3 |
| 2017 | Property and equipment | 52 | | | 52 | 169 |
| 2018 | Property and equipment | 10 | | | 10 | 35 |

As a result of reduced expectations of future cash flows from certain leased hotels, the Group determined that the hotels property and equipment with a carrying amount of RMB172, RMB221 and RMB45 was not fully recoverable and consequently recorded an impairment charge of RMB151, RMB169 and RMB35 for the years ended December 31, 2016, 2017 and 2018, respectively. As a result of the impairment assessment, the Group determined that the long term investment amount with a carrying amount of RMB3, nil and nil was impaired as a result of the impairment assessment for the years ended December 31, 2016, 2017 and 2018, respectively.

Fair value of the property and equipment impairment testing was determined by the Group based on the income approach using the discounted cash flow associated with the underlying assets, which incorporated certain assumptions including projected hotels' revenue, growth rates and projected operating costs based on current economic condition, expectation of management and projected trends of current operating results. As a result, the Group has determined that the majority of the inputs used to value its long-lived assets held and used and its reporting units are unobservable inputs that fall within Level 3 of the fair value hierarchy. The revenue growth rate and the discount rate were the significant unobservable input used in the fair value measurement, which are 4% and 20%, respectively, for the years ended December 31, 2016, 2017 and 2018, respectively.

Table of Contents***Share-based compensation***

The Group recognizes share-based compensation in the consolidated statements of comprehensive income based on the fair value of equity awards on the date of the grant, with compensation expenses recognized over the period in which the grantee is required to provide service to the Group in exchange for the equity award. Vesting of certain equity awards are based on the performance conditions for a period of time following the grant date. Share-based compensation expense is recognized according to the Group's judgement of likely future performance and will be adjusted in future periods based on the actual performance. The share-based compensation expenses have been categorized as either hotel operating costs, general and administrative expenses or selling and marketing expenses, depending on the job functions of the grantees. For the years ended December 31, 2016, 2017 and 2018, the Group recognized share-based compensation expenses of RMB55, RMB66 and RMB83, respectively, which was classified as follows:

| | Years Ended December 31, | | |
|-------------------------------------|---------------------------------|-------------|-------------|
| | 2016 | 2017 | 2018 |
| Hotel operating costs | 13 | 20 | 27 |
| Selling and marketing expenses | 1 | 2 | 3 |
| General and administrative expenses | 41 | 44 | 53 |
| Total | 55 | 66 | 83 |

Earnings per share

Basic earnings per share is computed by dividing income attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares, which consist of the ordinary shares issuable upon the conversion of the convertible senior notes (using the if-converted method) and ordinary shares issuable upon the exercise of stock options and vest of nonvested restricted stocks (using the treasury stock method).

The loaned shares under the ADS lending agreement are excluded from both the basic and diluted earnings per share calculation unless default of the ADS lending arrangement occurs which the Group considered the possibility is remote.

Segment reporting

The Group identifies a business as an operating segment if: i) it engages in business activities from which it may earn revenues and incur expenses; ii) its operating results are regularly reviewed by the Chief Operating Decision Maker (CODM) to make decisions about resources to be allocated to the segment and assess its performance; and iii) it has available discrete financial information. The Group's chief operating decision maker has been identified as the chief executive officer. CODM regularly reviews the operation data, such as industrial metrics of revenue per available room, occupancy rate, and number of hotels by scale/brand, to assess the performance and allocate the resources at brand level. All the acquired business including Accor, Crystal Orange and Blossom Hill has been migrated to the Group's business, and the Group operates and manages its business as a single segment. Therefore, the Group has one single operating segment.

The Group primarily generates its revenues from customers in the PRC. Substantially all of the Group's long-lived assets are located in the PRC.

Treasury shares

Treasury shares represent shares repurchased by the Company that are no longer outstanding and are held by the Company. Treasury shares are accounted for under the cost method. As of December 31, 2018, under the repurchase plan, the Company had repurchased an aggregate of 3,096,764 ordinary shares on the open market for total cash consideration of RMB107. The repurchased shares were presented as treasury shares in shareholders' equity on the Group's consolidated balance sheets.

Table of Contents**Recently Issued Accounting Pronouncements****Adopted Accounting Standards**

The Group adopted the ASU 2014-09 and all related ASUs (collectively, the new revenue standards) on January 1, 2018 utilizing the full retrospective basis in the consolidated financial statements, which required the Group to adjust each prior reporting period presented. The adoption of new revenue standards impacted the timing of revenue recognition related to initial one-time franchise fee from upon the opening of hotels to over the term of the franchise contract. In addition, the adoption of new revenue standards also impacted the accounting of the loyalty program. Under previous guidance, the Group adopted the incremental cost model to account for customer loyalty program. The estimated incremental costs, net of the reimbursement received from the franchisees, were accrued and recorded as accruals for customer loyalty program as members accumulate points and were recognized as cost and expense in the accompanying consolidated statements of comprehensive income. Upon adoption of new revenue standards, loyalty program is considered a separate performance obligation and the consideration allocated to the loyalty program are recognized as revenue upon point redemption, net of any cost paid to the franchisees and other third parties. The impact of the changes made to the Group's consolidated financial statements as a result of the adoption of new revenue standards was as follows:

| | Years Ended December 31, | | | | | |
|---|--------------------------|--|----------------|-------------|--|-------------|
| | As Reported | 2016 Effect of the Adoption of New Revenue Standards | As Adjusted | As Reported | 2017 Effect of the Adoption of New Revenue Standards | As Adjusted |
| Revenues: | | | | | | |
| Leased and owned hotels | 5,212 | 27 | 5,239 | 6,343 | (5) | 6,338 |
| Manachised and franchised hotels | 1,412 | 7 | 1,419 | 1,787 | 64 | 1,851 |
| Total revenues | 6,655 | 34 | 6,689 | 8,170 | 59 | 8,229 |
| Net revenues | 6,539 | 34 | 6,573 | 8,170 | 59 | 8,229 |
| Operating costs and expenses: | | | | | | |
| Hotel operating costs | 4,932 | 2 | 4,934 | 5,674 | 1 | 5,675 |
| Selling and marketing expenses | 146 | 63 | 209 | 215 | 70 | 285 |
| Total operating costs and expenses | 5,650 | 65 | 5,715 | 6,803 | 71 | 6,874 |
| Income from operations | 872 | (31) | 841 | 1,438 | (12) | 1,426 |
| Income before income taxes | 1,078 | (31) | 1,047 | 1,609 | (12) | 1,597 |
| Income tax expense | 287 | (8) | 279 | 360 | (3) | 357 |
| Net income | 797 | (23) | 774 | 1,237 | (9) | 1,228 |
| Net income attributable to Huazhu Group Limited | 805 | (23) | 782 | 1,237 | (9) | 1,228 |
| Earnings per share: | | | | | | |
| Basic | 2.92 | | 2.84 | 4.43 | | 4.40 |
| Diluted | 2.84 | | 2.76 | 4.24 | | 4.21 |

| | December 31, 2017 | |
|--|-------------------|--|
| | As Reported | Effect of the Adoption of New Revenue Standards |
| | | As Adjusted |

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| | | | |
|--|--------|-------|--------|
| Deferred tax assets | 326 | 80 | 406 |
| Total assets | 17,428 | 80 | 17,508 |
| Deferred revenue - current | 832 | 111 | 943 |
| Accrued expenses and other current liabilities | 1,265 | (16) | 1,249 |
| Deferred revenue - noncurrent | 172 | 226 | 398 |
| Total liabilities | 10,953 | 321 | 11,274 |
| Retained earnings | 2,754 | (241) | 2,513 |
| Total equity | 6,475 | (241) | 6,234 |
| Total liabilities and equity | 17,428 | 80 | 17,508 |

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In January 2016, the FASB issued ASU No. 2016-01, which improves the recognition and measurement of financial instruments. The new guidance requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income and separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Group adopted the ASU effective January 1, 2018. The unrealized gains (losses), net of tax, on the available-for-sale securities of RMB41 were reclassified from accumulated other comprehensive income to retained earnings as of January 1, 2018.

In November, 2016, the FASB issued ASU 2016-18, which amends ASC 230 to add or clarify guidance on the classification and presentation of restricted cash in the statement of cash flows. Under ASU 2016-18, restricted cash and restricted cash equivalents are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statements of cash flows. This ASU should be applied retrospectively and becomes effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, but early adoption is permitted. As a result of this update, restricted cash are included within cash and cash equivalents on the statements of consolidated cash flows. The Group adopted the ASU effective January 1, 2018. The balance of restricted cash of the Group of RMB361, RMB1 and RMB481 million are included within the beginning balance of cash, cash equivalents, and restricted cash on the statements of consolidated cash flows for the year ended December 31, 2016, 2017 and 2018, respectively.

In June, 2018, the FASB issued ASU 2018-07, which simplifies aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. The ASU is effective for public business entities for fiscal years beginning after December 15, 2018. The Group's early adoption of this ASU in the year ended December 31, 2018 had no material impact on the Group's consolidated financial statements.

Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities with certain practical expedients available on the balance sheet and disclosing key information about leasing arrangements. The accounting for lessors remains largely unchanged. Subsequent to ASU 2016-02, the FASB issued related ASUs, including ASU No. 2018-11 (ASU 2018-11), *Leases (Topic 842): Targeted Improvements*, which provides for another transition method in addition to the modified retrospective approach required by ASU 2016-02. This option allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative adjustment to the opening balance of retained earnings in the period of adoption. The provisions of ASU 2016-02, and all related ASUs, are effective for interim periods and fiscal years beginning after December 15, 2018, with early adoption permitted. The Group expect to adopt ASU 2016-02 utilizing the optional transition approach allowed under ASU 2018-11 and applying the package of practical expedients beginning January 1, 2019. By applying ASU 2016-02 at the adoption date, as opposed to at the beginning of the earliest period presented, the reporting for periods prior to January 1, 2019 will continue to be reported in accordance with Leases (Topic 840). The Group expects material changes to its consolidated balance sheet. On January 1, 2019, the Group expects to recognize right-of-use lease assets in the range of RMB19 billion to RMB22 billion and related lease liabilities in the range of RMB20 billion to RMB23 billion for operating leases. As a result of adoption, the Group will reclassify from assets and liabilities approximately RMB1 billion, net to right-of-use lease assets which has been factored into the range above. The Group does not believe the standard will materially affect the consolidated statements of income or consolidated statements of cash flows. The standard will have no impact on the debt covenant compliance under the current agreements.

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In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other*, which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under the ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, the ASU clarifies the requirements for excluding and allocating foreign currency translation adjustments to reporting units in connection with an entity's testing of reporting units for goodwill impairment. The ASU also clarifies that an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. For public business entities, the ASU is effective prospectively for fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Group is in the process of evaluating the impact on the consolidated financial statements.

In June 2016, the FASB released Accounting Standards Update No.2016-13 (ASU 2016-13), *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 replaces the existing impairment model for most financial assets from an incurred loss impairment model to a current expected credit loss model, which requires an entity to recognize an impairment allowance equal to its current estimate of all contractual cash flows the entity does not expect to collect. ASU 2016-13 also requires credit losses relating to AFS debt securities to be recognized through an allowance for credit losses. The provisions of ASU 2016-13 are to be applied using a modified retrospective approach and are effective for interim periods and fiscal years beginning after December 15, 2019, with early adoption permitted. The Group is currently evaluating the impact of adopting ASU 2016-13.

In August 2018, the FASB released Accounting Standards Update No. 2018-13 (ASU 2018-13), *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 modifies the disclosure requirements on fair value measurements. The provisions of ASU 2018-13 are to be applied using a prospective or retrospective approach, depending on the amendment, and are effective for interim periods and fiscal years beginning after December 15, 2019, with early adoption permitted. The Group is still evaluating the impact of adopting ASU 2018-13.

In August 2018, the FASB released Accounting Standards Update No. 2018-15 (ASU 2018-15), *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The provisions of ASU 2018-15 are to be applied using a prospective or retrospective approach and are effective for interim periods and fiscal years beginning after December 15, 2019, with early adoption permitted. The Group is currently evaluating the impact of adopting ASU 2018-15.

Translation into United States Dollars

The financial statements of the Group are stated in RMB. Translations of amounts from RMB into United States dollars are solely for the convenience of the reader and were calculated at the rate of US\$1 = RMB6.8755, on December 31, 2018, as set forth in H.10 statistical release of the Federal Reserve Board. The translation is not intended to imply that the RMB amounts could have been, or could be, converted, realized or settled into United States dollars at that rate on December 31, 2018, or at any other rate.

Table of Contents**3. ACQUISITIONS**

(i) In January 2016, the Group completed the transaction of strategic alliance with AccorHotels (Accor). Pursuant to the master purchase agreement, the Group acquired 100% equity interest 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, as well as a non-controlling stake of 28% for Accor Luxury and Upscale hotel operating platform, held by AAPC Hotel Management Limited (AAPC LUB) in Greater China. The total consideration consists of consideration amounted to RMB1,144, which was measured at the market price of the 24,895,543 ordinary shares on the issuance date and cash consideration of RMB120.

The net revenue and net income of the acquiree included in the consolidated statements of operations for the year ended December 31, 2016 were RMB153 and RMB64, respectively.

The following is a summary of the fair values of the assets acquired and liabilities assumed:

| | 2016 | Amortization Period |
|--------------------------|-------------|----------------------------|
| Current assets | 207 | |
| Property and equipment | 311 | 5-30 years |
| Favorable leases | 3 | remaining lease terms |
| Master brand agreement | 192 | |
| Land use rights | 150 | remaining contracts terms |
| Long-term investments | 418 | |
| Goodwill | 63 | |
| Other noncurrent assets | 2 | |
| Current liabilities | (39) | |
| Deferred tax liabilities | (43) | |
| Total | 1,264 | |

(ii) On May 25, 2017, the Group completed the acquisition of 100% of the equity interest of Crystal Orange Hotel Holdings Limited (the Crystal Orange) engaged in the business of owning, leasing, franchising, operating and managing hotels under Crystal Orange brands in the midscale market in the PRC, with an aggregated consideration in cash of approximately RMB3,765.

The net revenue and net income of the acquiree included in the consolidated statements of operations for the year ended December 31, 2017 were RMB777 and RMB100, respectively.

The following table summarizes unaudited pro forma results of operation for the years ended December 31, 2016 and 2017 assuming that the acquisition occurred as of January 1, 2016. The pro forma results have been prepared for comparative purpose only based on management's best estimate and do not purport to be indicative of the results of operations which actually would have resulted had the acquisition occurred as of January 1, 2016.

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| | Years Ended December 31, | |
|-----------------------|--------------------------|-------|
| | 2016 | 2017 |
| Pro forma net revenue | 7,508 | 8,630 |
| Pro forma net income | 835 | 1,267 |

The Group incurred transaction cost of RMB46 for the acquisition, which was expensed in 2017. In addition, Crystal Orange incurred certain costs directly attributable to the business combination including RMB256 related to the consultation services agreements and option cancellation agreement. These expenses are non-recurring in nature, and were eliminated from the calculation of pro forma net income above.

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The following is a summary of the fair values of the assets acquired and liabilities assumed:

| | 2017 | Amortization Period |
|--------------------------|-------------|----------------------------|
| Current assets | 137 | |
| Property and equipment | 842 | 3-20 years |
| Favorable leases | 91 | remaining lease terms |
| Franchise agreement | 58 | remaining contract terms |
| Brand Name | 1,142 | indefinite life |
| Goodwill | 2,093 | |
| Other noncurrent assets | 131 | |
| Current liabilities | (222) | |
| Noncurrent liabilities | (180) | |
| Deferred tax liabilities | (323) | |
| Noncontrolling interest | (4) | |
| Total | 3,765 | |

(iii) In August, 2018, the Group completed the acquisition of 83% equity interest of Blossom Hill Hotel Investment Management (Kunshan) Co., Ltd. (the "Blossom Hill"). Blossom Hill was engaged in the business of owning, leasing, franchising, operating and managing hotels under Blossom Hill brand in the upscale market in the PRC. The aggregated consideration RMB536 consisted of RMB463 cash consideration transferred and RMB73 implied fair value of the 11% equity interest originally owned by the Group. The previously held 11% equity interest that was accounted for using cost method was remeasured to fair value on the acquisition date, resulting in a gain of RMB13 recognized in investment income.

The net revenue and net loss of the acquiree included in the consolidated statements of operations for the year ended December 31, 2018 were RMB30 and RMB15, respectively.

The following table summarizes unaudited pro forma results of operation for the years ended December 31, 2017 and 2018 assuming that the acquisition occurred as of January 1, 2017. The pro forma results have been prepared for comparative purpose only based on management's best estimate and do not purport to be indicative of the results of operations which actually would have resulted had the acquisition occurred as of January 1, 2017.

| | Years Ended December 31, | |
|-----------------------|---------------------------------|-------------|
| | 2017 | 2018 |
| Pro forma net revenue | 8,331 | 10,124 |
| Pro forma net income | 1,214 | 701 |

The transaction cost for the acquisition was immaterial.

The following is a summary of the fair values of the assets acquired and liabilities assumed:

| | 2018 | Amortization Period |
|--|-------------|----------------------------|
|--|-------------|----------------------------|

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| | | |
|--------------------------|-------|--------------------------|
| Current assets | 84 | |
| Property and equipment | 187 | 3-20 years |
| Favorable leases | 7 | remaining lease terms |
| Unfavorable leases | (1) | remaining lease terms |
| Franchise agreement | 25 | remaining contract terms |
| Brand name | 170 | indefinite life |
| Goodwill | 365 | |
| Land use rights | 10 | |
| Deferred tax assets | 12 | |
| Current liabilities | (105) | |
| Noncurrent liabilities | (18) | |
| Deferred tax liabilities | (50) | |
| Noncontrolling interest | (150) | |
| Total | 536 | |

In August 2018, the Group purchased 11% noncontrolling interest from several minority shareholders for total cash consideration of RMB73. The purchase of the noncontrolling interest is treated as an equity transaction. As of December 31, 2018, the Group owns 94% equity interest of Blossom Hill in total.

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(iv) During the years ended December 31, 2016, 2017 and 2018, the Group acquired two individual hotels, two individual hotels, and two individual hotels for total cash consideration of RMB3, nil and RMB7, respectively. The business acquisitions were accounted for under purchase accounting. The assets and liabilities of these acquired hotels were immaterial to the consolidated financial statements.

Goodwill was recognized as a result of expected synergies from combining operations of the Group and acquired business and other intangible assets that don't qualify for separate recognition. Goodwill is not amortized and is not deductible for tax purposes. In accordance with ASC 350, the Group assigned and assessed goodwill for impairment at the reporting unit level. All the acquired business has been migrated to the Group's business. The Group concluded that it had only one reporting unit. Accordingly, goodwill is allocated to one single reporting unit.

4. REVENUE FROM CONTRACTS WITH CUSTOMERS

Disaggregated Revenues

The following tables present our revenues disaggregated by the nature of the product or service:

| | Years Ended December 31, | | |
|--|--------------------------|--------------|---------------|
| | 2016 | 2017 | 2018 |
| Room revenues | 4,781 | 5,842 | 6,894 |
| Food and beverage revenues | 218 | 249 | 304 |
| Others | 240 | 247 | 272 |
| Leased and owned hotels revenue | 5,239 | 6,338 | 7,470 |
| Initial one-time franchise fee | 56 | 59 | 79 |
| On-going management and service fees | 589 | 759 | 983 |
| Central reservation system usage fees, other system maintenance and support fees | 308 | 436 | 630 |
| Reimbursements for hotel manager fees | 321 | 371 | 455 |
| Other fees | 145 | 226 | 380 |
| Managed and franchised hotels revenue | 1,419 | 1,851 | 2,527 |
| Other revenues | 31 | 40 | 66 |
| Total revenues | 6,689 | 8,229 | 10,063 |

Contract Balances

Our contract assets are insignificant at December 31, 2017 and December 31, 2018.

| | As of December 31, | |
|--------------------------------|--------------------|-------|
| | 2017 | 2018 |
| Current contract liabilities | 943 | 1,005 |
| Long-term contract liabilities | 398 | 458 |

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| | | |
|----------------------------|-------|-------|
| Total contract liabilities | 1,341 | 1,463 |
|----------------------------|-------|-------|

The contract liabilities balances above, as of December 31, 2017 and 2018 were comprised of the following:

| | As of December 31, | |
|---|--------------------|-------|
| | 2017 | 2018 |
| Initial fees received from franchisees owners | 553 | 674 |
| Cash received for membership fees and not recognized as revenue | 305 | 357 |
| Advances received from customers | 425 | 374 |
| Deferred revenue related to the loyalty program | 58 | 58 |
| Total | 1,341 | 1,463 |

We recognized revenues that were previously deferred as contract liabilities of RMB445 and RMB468 during the years ended December 31, 2017 and 2018, respectively.

Table of Contents***Revenue Allocated to Remaining Performance Obligations***

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and amounts that will be invoiced and recognized as revenue in future periods.

As of December 31, 2018, we had RMB58 of deferred revenues related to unsatisfied performance obligations under HUAZHU Rewards that will be recognized as revenues when the points are redeemed, which we estimate will occur over the next two years. We had RMB674 of deferred revenues related to initial fees received from franchisees owners are expected to be recognized as revenues over the remaining contract periods over one to ten years. Additionally, we had RMB357 of deferred revenues related to membership fees that are expected to be recognized as revenues over the remaining membership life, which is estimated to be one to five years. We also had RMB374 of deferred revenues related to advances received from customers, which are expected to be recognized as revenues in future periods over the terms of the related contracts.

We did not estimate revenues expected to be recognized related to our unsatisfied performance for the following:

- Revenues related to on-going management and franchise service fees, as they are considered sales-based royalty fees.
- Revenues related to central reservation system usage fees, other system maintenance and support fees, and reimbursement for hotel manager fee, as the related revenues from the satisfaction of these performance obligations is recognized when the Group is entitled to invoice the amount.

5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consist of the following:

| | As of December 31, | |
|-----------------------------------|--------------------|---------|
| | 2017 | 2018 |
| Cost: | | |
| Buildings | 247 | 247 |
| Leasehold improvements | 6,453 | 7,389 |
| Furniture, fixtures and equipment | 1,034 | 1,162 |
| Motor vehicles | 1 | 1 |
| | 7,735 | 8,799 |
| Less: Accumulated depreciation | (3,707) | (4,344) |
| | 4,028 | 4,455 |
| Construction in progress | 495 | 563 |
| Property and equipment, net | 4,523 | 5,018 |

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Depreciation expense was RMB674, RMB753 and RMB847 for the years ended December 31, 2016, 2017 and 2018, respectively.

The Group occasionally demolishes certain leased hotels due to local government zoning requirements, which typically results in receiving compensation from the government.

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Table of Contents**6. INTANGIBLE ASSETS, NET AND UNFAVORABLE LEASE**

Intangible assets, net consist of the following:

| | As of December 31, | |
|--|--------------------|-------|
| | 2017 | 2018 |
| <i>Intangible assets with indefinite life:</i> | | |
| Brand name (Note 3) | 1,170 | 1,340 |
| Master brand agreement (Note 3) | 192 | 192 |
| <i>Intangible assets with definite life:</i> | | |
| Franchise agreements | 70 | 95 |
| Non-compete agreement | 0 | 0 |
| Favorable lease agreements | 256 | 278 |
| Purchased software | 65 | 69 |
| Total | 1,753 | 1,974 |
| Less: Accumulated amortization | (109) | (140) |
| Total | 1,644 | 1,834 |

Unfavorable lease

| | As of December 31, | |
|-----------------------------------|--------------------|------|
| | 2017 | 2018 |
| Unfavorable lease agreements | 4 | 3 |
| Less: Accumulated amortization | (3) | (2) |
| Unfavorable lease agreements, net | 1 | 1 |

The values of favorable lease agreements were determined based on the estimated present value of the amount the Group has avoided paying as a result of entering into the lease agreements. Unfavorable lease agreements were determined based on the estimated present value of the acquired lease that exceeded market prices and are recognized as other long-term liabilities. The value of favorable and unfavorable lease agreements is amortized using the straight-line method over the remaining lease term.

Amortization expense of intangible assets for the years ended December 31, 2016, 2017 and 2018 amounted to RMB17, RMB31 and RMB39, respectively.

The annual estimated amortization expense for the above intangible assets and unfavorable lease excluding brand name and master brand agreement for the following years is as follows:

| | Amortization for Intangible Assets | Amortization for Unfavorable Lease | Net Amortization |
|------|---------------------------------------|---------------------------------------|------------------|
| 2019 | 37 | 0 | 37 |
| 2020 | 35 | 0 | 35 |

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| | | | |
|------------|-----|---|-----|
| 2021 | 34 | 0 | 34 |
| 2022 | 32 | 0 | 32 |
| 2023 | 30 | 0 | 30 |
| Thereafter | 134 | 1 | 133 |
| Total | 302 | 1 | 301 |

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Table of Contents**7. INVESTMENTS**

The investments as of December 31, 2017 and 2018 were as follows:

| | As of December 31, | |
|---|--------------------|-------|
| | 2017 | 2018 |
| <i>Equity securities with readily determinable fair values:</i> | | |
| Accor | 780 | 3,816 |
| Other marketable securities | 257 | 295 |
| <i>Equity securities without readily determinable fair values:</i> | | |
| OYO | 66 | 66 |
| Mobike | 67 | |
| BJ GOOAGOO/GOOAGOO | 60 | |
| Blossom Hill (Note 3) | 60 | |
| Other equity securities without readily determinable fair values | 103 | 113 |
| <i>Equity-method investments:</i> | | |
| AAPC LUB | 478 | 461 |
| Hotel related funds | 56 | 503 |
| Shared office management entities | 148 | 111 |
| China Young | 41 | 34 |
| Cjia/Cjia Group | | 298 |
| China Hospitality JV | | 117 |
| BJ GOOAGOO/GOOAGOO | | 52 |
| Other investments | 30 | 55 |
| <i>Available-for-sale debt securities:</i> | | |
| Cjia/Cjia Group | 246 | 220 |
| CREATER | 100 | 100 |
| Total | 2,492 | 6,241 |

Equity securities with readily determinable fair values:

In 2017 and 2018, the Group purchased 2,309,981 and 10,782,131 ordinary shares of Accor, a hotel group listed in Paris stock exchange, from open market. As of December 31, 2018, the Group accumulatively hold 13,092,112 shares of Accor, which accounts for less than 5% of Accor total outstanding shares where the Group does not have the ability to significantly influence the operations of this entity. In 2018, along with the adoption of ASU 2016-01, the Group recognized unrealized losses from fair value changes of Accor of RMB794.

At December 31, 2017 and December 31, 2018, the Group had RMB257 and RMB295, respectively, of other marketable securities, which represent investments in entities in hospitality or related industries where the Group do not have the ability to significantly influence the operations of these entities. In 2018, the Group recognized unrealized losses from fair value changes of other marketable securities of RMB120.

Equity securities without readily determinable fair values:

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In September 2017, the Group purchased approximately 1% equity interest of Oravel Stays Private limited (OYO), an India leading hospitality company. The Group accounted the investment as equity securities without readily determinable fair values since the Group does not have the ability to exert significant influence over OYO.

In January 2017, the Group purchased 1,316,205 preferred shares and invested in convertible notes with principal amount of US\$5.0 million and interest rate of 8% of Mobike Ltd. (Mobike), a Chinese bike-sharing company. As of December 31, 2017, the Group had less than 1% equity interest of Mobike. The Group accounted the investment at cost method prior to 2018. Along with the adoption of ASC 2016-01, the Group accounted it as equity securities without readily determinable fair values. In 2018, the Group disposed all the Mobike preferred shares and recognized a gain of RMB55.

Other equity securities without readily determinable fair values included several insignificant investments in certain privately-held companies.

Table of Contents*Equity-method investments:*

In January 2016, the Group acquired approximately 28% equity interest in AAPC LUB (Note 3). The Group accounted for the investment in AAPC LUB under equity-method as the Group has the ability to exert significant influence. The Group recognized investment income of RMB31 and RMB43 in income (loss) from equity method investments in 2017 and 2018, respectively. In 2018, the Group received cash dividend from AAPC LUB of RMB60 which was recognized as a return on investment.

As of December 31, 2017 and 2018, the Group had RMB56 and RMB503, respectively, of investments in hotel related funds. Those funds were VIEs and were managed by or power shared with un-related third-parties. However, the Group determined that they were not the primary beneficiary of those VIEs since the Group did not have the power to direct the activities of these VIEs that most significantly impacted its economic performance. The Group accounted for the investment under equity-method. The Group recognized investment loss of nil and RMB28 in income (loss) from equity method investments in 2017 and 2018, respectively. The maximum potential financial statement loss the Group could incur if the investment funds were to default on all of their obligations is the loss of value of the interests in such investments of RMB503 that the Group holds as of December 31, 2018.

In 2016, the Group sold its subsidiary, Chengjia Hotel Management Co., Ltd. to Chengjia (Shanghai) Apartment Management Co., Limited (Cjia), the Group's equity investee. As a result, the Group recognized a gain of RMB50 in other income in 2016. As of December 31, 2016, the Group had approximately 23% equity interest of Cjia and a sixty-month convertible note with original value of RMB52. In 2017, the Group invested in Cjia for convertible notes totaled RMB200. With the injection from an unrelated investor to Cjia, the Group recognized gain on deemed disposal of RMB40 in other income in 2017. As of December 31, 2017, the Group had approximately 17% equity interest and three convertible notes with original value totaled RMB252 of Cjia. The Group accounted for the equity investment in Cjia under equity-method as the Group has the ability to exert significant influence. The convertible notes are recorded as available-for-sale debt securities. In 2018, Cjia completed its restructuring, and accordingly the Company's equity interest of 17% in Cjia was transformed to be the Group's equity interest of 17% in China Cjia Group Limited (Cjia Group). In addition, the Group made further investment in preferred shares of Cjia Group of US\$45 million in 2018. Meanwhile, the convertible notes of Cjia could be replaced by converted notes of Cjia Group in the next four years. The Group recognized investment loss of RMB25, RMB33 and RMB38 in income (loss) from equity method investments in 2016, 2017 and 2018, respectively. Loss from equity method investments reduced the cost of equity-method investment to zero and further adjusted the carrying amount of convertible notes and preferred shares.

In 2018, the Group partnered with an unrelated third party investor to form China Hospitality JV, Ltd. (China Hospitality JV), of which the Group holds 20% equity interest. The business of China Hospitality JV was to acquire and operate two hotel properties. As of December 31, 2018, the Group had approximately 20% equity interest of China Hospitality JV. The Group accounted for the investment in China Hospitality JV under equity-method as the Group has the ability to exert significant influence. The Group recognized investment loss of RMB11 in income (loss) from equity method investments in 2018.

In 2014, the Group purchased approximately 8% equity interest in Beijing GOOAGOO Technology Service Co., Ltd. (BJ GOOAGOO), a high-tech service provider for Offline-To-Online data processing and platform operation. After restructuring of BJ GOOAGOO and further investment of the Group in 2015 and 2016, as of December 31, 2017, the Group had approximately 19% equity interest of in Gooagoo Group Holdings Limited (GOOAGOO). The Group accounted for the investment as equity securities without readily determinable fair values since the Group does not have the ability to exert significant influence over those companies. In 2018, the Group further invested in GOOAGOO. As of December 31, 2018, the Group had approximately 41% equity interest of in GOOAGOO and reclassified GOOAGOO from equity securities without readily determinable fair values to equity-method investments as the Group has the ability to exert significant influence through the increased voting power. The Group recognized investment loss of RMB14 in income (loss) from equity method investments in 2018.

Other investments included several insignificant equity investments in certain privately-held companies.

Table of Contents*Available-for-sale debt securities:*

In September 2017, the Group invested in Shanghai CREATER Industrial Co., Ltd. (CREATER), a staged office space company in China, for two-year convertible notes amounted RMB100 with an interest rate of 10% per year. The convertible notes with equity pledge are convertible upon satisfaction of certain conditions or at the option of the Group to ordinary shares in the last month before the expiration. The convertible notes are recorded as available-for-sale debt securities.

8. GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2016, 2017 and 2018 were as follows:

| | Gross Amount | Accumulated Impairment Loss | Net Amount |
|--|-------------------------|--|-----------------------|
| Balance at January 1, 2016 | 113 | (4) | 109 |
| Increase in goodwill related to acquisitions | 63 | | 63 |
| Balance at December 31, 2016 | 176 | (4) | 172 |
| Increase in goodwill related to acquisitions | 2,093 | | 2,093 |
| Balance at December 31, 2017 | 2,269 | (4) | 2,265 |
| Increase in goodwill related to acquisitions | 365 | | 365 |
| Balance at December 31, 2018 | 2,634 | (4) | 2,630 |

Table of Contents**9. DEBT**

The short-term and long-term debt as of December 31, 2017 and 2018 were as follows:

| | As of December 31, | |
|--|--------------------|-------|
| | 2017 | 2018 |
| <i>Short-term debt:</i> | | |
| Long-term bank borrowings, current portion | 0 | 0 |
| Short-term bank borrowings | 131 | 948 |
| Total | 131 | 948 |
| <i>Long-term debt:</i> | | |
| Long-term bank borrowings, non-current portion | 1,895 | 5,603 |
| Convertible senior notes | 3,027 | 3,209 |
| Total | 4,922 | 8,812 |

Bank borrowings

In May 2017, the Group entered into an US\$250 million term facility and US\$250 million revolving credit facility agreement with several banks. The US\$250 million revolving credit facility is available for 35 months after the date of the agreement. The interest rate on the loan is Libor plus 1.75%. There are some financial covenants including interest coverage ratio, leverage and tangible net worth related to this facility and the Group was in compliance as of December 31, 2017 and 2018. The Group had drawn down US\$250 million under the term facility agreement in 2017 and repaid nil in 2017 and 2018. For revolving credit facility agreement, the Group had drawn down US\$250 million in May 2017 and fully repaid the amount in November 2017. The group had drawn down total US\$370 million in succession under the revolving facility agreement and repaid US\$ 120 million in 2018. The weighted average interest rate of borrowings drawn under this agreement was 3.04% and 3.93% for the years ended December 31, 2017 and 2018, respectively.

In February 2018, the Group entered into a three-year term facility agreement under which the Group can borrow up to EUR260 million within 30 London business days. The interest rate on the loan for each interest period is the aggregate of the applicable EURIBOR and a spread of 1.70%. The Group had pledged 13,092,112 shares of Accor the Group acquired from open market in 2017 and 2018 as collateral. The loan contains certain financial covenants including debt ratio and the value of pledged shares and the Group was in compliance as of December 31, 2018. The Group had drawn down EUR241 million under the term facility agreement in 2018 and repaid nil. The weighted average interest rate of borrowings drawn under this agreement was 1.70% for the year ended December 31 2018.

Convertible Senior Notes due 2022

On November 3, 2017, the Company issued US\$475 million of Convertible Senior Notes (the Notes). The Notes 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.

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Holders of the Notes have the option to convert their Notes at any time prior to the close of business on the second business day immediately preceding the maturity date. The Notes can be converted into the Company's ADSs at an initial conversion rate of 5.4869 of the Company's ADSs per US\$1,000 principal amount of the Notes (equivalent to an initial conversion price of US\$182.25 per ADS). The conversion rate is subject to adjustment in some events but is not adjusted for any accrued and unpaid interest. In addition, following a make-whole fundamental change (as defined in the Indenture) that occur prior to the maturity date or following the Company's delivery of a notice of a tax redemption, the Company will increase the conversion rate for a holder who elects to convert its notes in connection with such a corporate event or such tax redemption.

The holders may require the Company to repurchase all or portion of the Notes for cash on November 3, 2020, or upon a fundamental change, at a repurchase price equal to 100% of the principal amount, plus accrued and unpaid interest. The Company believes that the likelihood of occurrence of events considered a fundamental change is remote.

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The conversion option meets the definition of a derivative. However, since the conversion option is considered indexed to the Company's own stock and classified in stockholders' equity, the scope exception is met, accordingly the bifurcation of conversion option from the Notes is not required. There is no beneficial conversion feature (BCF) attribute to the Notes as the set conversion prices for the Notes are greater than the respective fair values of the ordinary share price at date of issuance.

The feature of mandatory redemption upon maturity is clearly and closely related to the debt host and this feature is no need to be bifurcated. Furthermore, the Company concluded that the feature of contingent put options upon tax events or fundamental changes does not need to be considered as an embedded derivative to be bifurcated.

Therefore, the Company accounted for the Notes in accordance with ASC 470, as a single instrument under long-term debt. Issuance costs related to the Notes is recorded in consolidated balance sheet as a direct deduction from the principal amount of the Notes, and is amortized over the period from November 3, 2017, the date of issuance, to November 1, 2020, the first put date of the Notes, using the effective interest method.

In 2017, proceeds to the Company were RMB3,093 (equivalently US\$467 million), net of issuance costs of RMB54 (equivalently US\$8 million).

ADS Lending Arrangement

Concurrent with the offering of the Notes, the Company entered into ADS lending agreements with the affiliates of the initial purchasers of the Notes (ADS Borrowers), pursuant to which the Company lent to the ADS Borrowers 2,606,278 ADSs (the Loaned ADSs) at a price equal to par, or \$0.0004 per ADS (ADS lending arrangement). The purpose of the ADS lending arrangements is to facilitate privately negotiated transactions in which the ultimate holders of the Notes may elect to hedge their investment in the related notes. As of December 31, 2017 and 2018, the outstanding number of Loaned ADSs was 2,606,278.

The Loaned ADSs must be returned to the Company by the earliest of (a) the maturity date of the Notes, November 1, 2022, (b) upon the Company's election to terminate the ADS lending agreement at any time after the later of (x) the date on which the entire principal amount of the Notes ceases to be outstanding, and (y) the date on which the entire principal amount of any additional convertible securities that the Company has in writing consented to permit the ADS Borrower to hedge under the ADS lending agreement ceases to be outstanding, in each case, whether as a result of conversion, redemption, repurchase, cancellation or otherwise; and (c) the termination of the ADS lending agreement. The Company is not required to make any payment to the initial purchasers or ADS Borrower upon the return of the Loaned ADSs. The ADS Borrowers do not have the choice or option to pay cash in exchange for the return of the Loaned ADSs.

No collateral is required to be posted for the Loaned ADSs. The initial purchasers are required to remit to the Company any dividends paid to the holders of the Loaned ADSs. An ADS Borrower has the ability to vote without restriction. However, the ADS Borrowers have agreed not to vote on the Loaned ADSs.

In accordance with FASB ASC Sub-topic 470-20, the Company has accounted for the ADS lending agreement initially at fair value and recognized it as an issuance cost associated with the convertible debt offering. As a result, additional debt issuance costs of RMB26

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(equivalently US\$4 million) were recorded on the issuance date with a corresponding increase to additional paid-in-capital. This debt issuance costs have also been amortized from the date of issuance to the put date of Notes, using the effective interest method.

In accordance with ASC Topic 470-20, although legally issued, the Loaned ADSs are not considered outstanding, and then excluded from basic and diluted earnings per share unless default of the ADS lending arrangement occurs, at which time the Loaned ADSs would be included in the basic and diluted earnings per share calculation. As of December 31, 2018, it is not probable that the ADS Borrower or the counterparty to the ADS lending arrangement will default.

Table of Contents*Capped Call Options*

In connection with the issuance of the Notes, the Company has entered into capped call option transactions with some of the initial purchasers or their affiliates (the Option Counterparties) to reduce the potential dilution to existing shareholders of the Company upon conversion of the Notes. The cap price of the capped call transactions will initially be US\$221.31 per ADS, subject to adjustment under the terms of the capped call transactions. The total premium paid by the Company for the capped call transactions was RMB177 (equivalently US\$27 million) on the purchased date. The capped call option is classified in stockholders' equity, recorded at the cost with no subsequent changes in fair value be recorded.

10. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

| | As of December 31, | |
|--|--------------------|-------|
| | 2017 | 2018 |
| Payable for business acquisitions | 118 | 39 |
| Liabilities related to customer loyalty program | 138 | 154 |
| Payable to noncontrolling interest holders | 87 | 107 |
| Payable to franchisees | 418 | 698 |
| Other payables | 264 | 351 |
| Accrued rental, utilities and other accrued expenses | 174 | 187 |
| Deferred rent, current | 50 | 71 |
| Total | 1,249 | 1,607 |

From time to time, the Group receives cash advances from noncontrolling interest holders of hotels that are not wholly owned by the Group. Such advances are non-interest bearing and are payable within one year. Payable to franchisees mainly represents room charges received on behalf of franchisees and are payable within one year.

11. HOTEL OPERATING COSTS

Hotel operating costs include all direct costs incurred in the operation of the leased and owned hotels, managed and franchised hotels and consist of the following:

| | Years Ended December 31, | | |
|-------------------------------|--------------------------|-------|-------|
| | 2016 | 2017 | 2018 |
| Rents | 1,871 | 2,059 | 2,406 |
| Utilities | 346 | 366 | 399 |
| Personnel costs | 1,089 | 1,388 | 1,663 |
| Depreciation and amortization | 677 | 773 | 869 |
| Consumable, food and beverage | 495 | 551 | 673 |
| Others | 456 | 538 | 466 |
| Total | 4,934 | 5,675 | 6,476 |

12. PRE-OPENING EXPENSES

The Group expenses all costs incurred in connection with start-up activities, including pre-operating costs associated with new hotel facilities and costs incurred with the formation of the subsidiaries, such as organization costs. Pre-opening expenses primarily include rental expenses and employee costs incurred during the hotel pre-opening period.

| | Years Ended December 31, | | |
|-----------------|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| Rents | 67 | 192 | 221 |
| Personnel costs | 2 | 6 | 18 |
| Others | 3 | 8 | 16 |
| Total | 72 | 206 | 255 |

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Table of Contents**13. SHARE-BASED COMPENSATION**

In February 2007, the Group adopted the 2007 Global Share Plan which allows the Group to offer incentive awards to employees, officers, directors and consultants or advisors (the Participants). Under the 2007 Global Share Plan, the Group may issue incentive awards to the Participants to purchase not more than 10,000,000 ordinary shares. In June 2007, the Group adopted the 2008 Global Share Plan which allows the Group to offer incentive awards to Participants to purchase up to 3,000,000 ordinary shares. In October 2008, the Group increased the maximum number of incentive awards available under the 2008 Global Share Plan to 7,000,000. In September 2009, the Group adopted the 2009 Share Incentive Plan which allows the Group to offer incentive awards to Participants. Under the 2009 Share Incentive Plan, the Group may issue incentive awards to purchase up to 3,000,000 ordinary shares. In August 2010, the Group increased the maximum number of incentive awards available under the 2009 Share Incentive Plan to 15,000,000. In March 2015, the Group increased the maximum number of incentive awards available under the 2009 Share Incentive Plan to 43,000,000. The 2007 and 2008 Global Share Plans and 2009 Share Incentive Plan (collectively, the Incentive Award Plans) contain the same terms and conditions. The incentive awards granted under the Incentive Award Plans typically have a maximum life of ten years and vest in typical ways as listed below:

- a.) Vest 50% on the second anniversary of the stated vesting commencement date with the remaining 50% vesting ratably over the following two years;
- b.) Vest over a period of ten years in equal yearly installments;

As of December 31, 2018, the Group had granted 24,577,669 options and 23,795,090 nonvested restricted stocks.

Share options

No share options were granted during the years 2016, 2017 and 2018.

The following table summarized the Group's share option activity under the option plans:

| | Number of Options | Weighted Average Exercise Price US\$ | Weighted Average Remaining Contractual Life Years | Aggregate Intrinsic Value US\$ million |
|--|----------------------|--|--|--|
| Share options outstanding at January 1, 2018 | 2,044,724 | 2.12 | | |
| Forfeited | (32,019) | 1.75 | | |
| Exercised | (876,715) | 2.42 | | |
| Share options outstanding at December 31, 2018 | 1,135,990 | 1.89 | 0.91 | 30 |
| Share options vested or expected to vest at December 31, 2018 | 1,125,336 | 1.87 | 0.89 | 30 |

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| | | | | |
|--|-----------|------|------|----|
| Share options exercisable at December 31, 2018 | 1,099,720 | 1.81 | 0.83 | 29 |
|--|-----------|------|------|----|

As of December 31, 2018, total unrecognized compensation expense related to unvested share-based compensation arrangements was immaterial, which is expected to be recognized over a weighted-average period of 1.10 years.

During the years ended December 31, 2016, 2017 and 2018, 684,632, 609,224 and 876,715 options were exercised with an aggregate intrinsic value of RMB41, RMB77 and RMB194 respectively.

Nonvested restricted stocks

The fair value of nonvested restricted stock with service conditions or performance conditions is based on the fair market value of the underlying ordinary shares on the date of grant.

In 2016 and 2018, the Group granted 1,876,975 and 661,973 nonvested restricted stocks, respectively to senior officers and managers, each was in ten tranches with performance conditions. Each tranche is accounted for as a separate award with the same grant date, its own service inception date and requisite service period. The share-based compensation cost is recognized for each vesting tranche during the respective service period based on the estimated performance conditions at the service inception date. The Group reassesses the performance condition at each reporting period for true up. For each tranche, 50% vests on the second anniversary of the vesting commencement date with the remaining 50% vesting ratably over the following two years.

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The following table summarized the Group's nonvested restricted stock activity in 2018.

| | Number of Restricted | Weighted Average Grant |
|--|----------------------|----------------------------|
| | Stocks | Date Fair Value US\$ |
| Nonvested restricted stocks outstanding at January 1, 2018 | 12,492,570 | 5.86 |
| Granted | 1,708,980 | 27.51 |
| Forfeited | (253,323) | 8.63 |
| Vested | (1,680,939) | 5.75 |
| Adjusted for performance conditions | (170,672) | 4.89 |
| Nonvested restricted stocks outstanding at December 31, 2018 | 12,096,616 | 8.89 |

As of December 31, 2018, there was RMB621 in unrecognized compensation costs, net of estimated forfeitures, related to unvested restricted stocks, which is expected to be recognized over a weighted-average period of 4.18 years.

The total fair value of nonvested restricted stocks vested in 2016, 2017 and 2018 was RMB123, RMB274 and RMB183, respectively.

14. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the years indicated:

| | Years Ended December 31, | | |
|---|--------------------------|-------------|-------------|
| | 2016 | 2017 | 2018 |
| Net income attributable to ordinary shareholders - basic | 782 | 1,228 | 716 |
| Eliminate the dilutive effect of interest expense of convertible senior notes | | 5 | 40 |
| Net income attributable to ordinary shareholders - diluted | 782 | 1,233 | 756 |
| Weighted average ordinary shares outstanding - basic | 275,139,070 | 279,272,140 | 281,717,485 |
| Incremental weighted-average ordinary shares from assumed exercise of share options and nonvested restricted stocks using the treasury stock method | 7,750,424 | 12,202,369 | 11,463,212 |
| Dilutive effect of convertible senior notes | | 1,599,469 | 10,425,112 |
| Weighted average ordinary shares outstanding - diluted | 282,889,494 | 293,073,978 | 303,605,809 |
| Basic earnings per share | 2.84 | 4.40 | 2.54 |
| Diluted earnings per share | 2.76 | 4.21 | 2.49 |

For the years ended December 31, 2016, 2017 and 2018, the Group had securities which could potentially dilute basic earnings per share in the future, but which were excluded from the computation of diluted earnings per share as their effects would have been anti-dilutive. Such outstanding securities consist of the following:

| | Years Ended December 31, | | |
|--|--------------------------|------|---------|
| | 2016 | 2017 | 2018 |
| Outstanding employee options and nonvested restricted stocks | | | 530,009 |

15. Cash Dividend

On October 23, 2017, the Group approved and declared a cash dividend of US\$0.16 per ordinary share on its outstanding shares as of the close of trading on December 15, 2017. Such dividend of RMB295 was recorded as a reduction against retained earnings, and the dividend of RMB11 attributable to ADS issued under the ADS lending arrangement was recorded as a receivable in other current assets as of December 31, 2017 and had been received in January 2018.

On December 13, 2018, the Group approved and declared a cash dividend of US\$0.34 per ordinary share on its outstanding shares as of the close of trading on January 2, 2019. Such dividend of RMB658 was recorded as dividends payable as of December 31, 2018, and fully paid in January 2019.

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16. INCOME TAXES

Cayman Islands

Under the current laws of the Cayman Islands, the Company, China Lodging Investment Limited, City Home Group Limited and CLG Special Investments Limited are not subject to tax on income or capital gain.

Hong Kong

China Lodging Holdings (HK) Limited, Starway Hotels (Hong Kong) Limited, IBIS China Investment Limited, ACL Greater China Limited, TAHM Investment Limited, City Home Investment Limited, Orange Hotel Hong Kong Limited, Huazhu Investment I Limited and Huazhu Investment II Limited are subject to Hong Kong profit tax at a rate of 16.5%.

Singapore

China Lodging Holdings Singapore Pte. Ltd. is subject to Singapore corporate income tax at a rate of 17% in 2016, 2017 and 2018. No Singapore profit tax has been provided as the Group has not had assessable profit that was earned in or derived from Singapore during the years presented.

British Virgin Islands

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.

Seychelles

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

PRC

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Under the Law of the People's Republic of China on Enterprise Income Tax (EIT Law), which was effective from January 1, 2008, domestically-owned enterprises and foreign-invested enterprises are subject to a uniform tax rate of 25%.

Hanting Suzhou was entitled to a reduced tax rate of 15% as it was qualified as high and new tech enterprise. The high and new tech enterprise qualification was expired in September, 2017, resulting Hanting Suzhou subject to a uniform tax rate of 25% in 2017 and 2018.

Jizhu Information and Technology (Shanghai) Co., Ltd. (Jizhu Shanghai), which once called Mengguang Information and Technology (Shanghai) Co., Ltd, is a recognized software development entity located in Shanghai of PRC. Jizhu Shanghai is entitled to a two-year exemption and three-year 50% reduction tax holiday starting from the first profit making year after absorbing all prior years' tax losses, and has entered into the first tax profitable year in 2014. Therefore, it applied tax exemption from 2014 to 2015, and tax rate of 12.5% from 2016 to 2018.

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Tax expense (benefit) is comprised of the following:

| | Years Ended December 31, | | |
|--------------|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| Current Tax | 253 | 436 | 660 |
| Deferred Tax | 26 | (79) | (91) |
| Total | 279 | 357 | 569 |

A reconciliation between the effective income tax rate and the PRC statutory income tax rate is as follows:

| | Years Ended December 31, | | |
|--|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| PRC statutory tax rate | 25% | 25% | 25% |
| Tax effect of non-deductible expenses and non-taxable income in determining taxable profit | 3% | 1% | 15% |
| Effect of different tax rate of group entities operating in other jurisdictions | (1)% | 1% | 4% |
| Effect of change in valuation allowance | 1% | | (1)% |
| Effect of tax holiday | (3)% | (1)% | (3)% |
| Effect of cash dividends | 3% | (1)% | 5% |
| Effect of disposal of subsidiary | (1)% | | 1% |
| Effect of excess tax benefit of rewards | | (3)% | (5)% |
| Effective tax rate | 27% | 22% | 41% |

The aggregate amount and per share effect of the tax holidays are as follows:

| | Years Ended December 31, | | |
|--------------------------|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| Aggregate amount | 27 | 24 | 31 |
| Per share effect basic | 0.10 | 0.09 | 0.11 |
| Per share effect diluted | 0.10 | 0.08 | 0.10 |

The principal components of the Group's deferred income tax assets and liabilities as of December 31, 2017 and 2018 are as follows:

| | As of December 31, | |
|---|--------------------|------|
| | 2017 | 2018 |
| Deferred tax assets: | | |
| Net loss carryforward | 140 | 181 |
| Deferred revenue | 159 | 186 |
| Deferred rent | 9 | 5 |
| Long-term assets | 130 | 149 |
| Bad debt provision | 4 | 6 |
| Liabilities related to customer loyalty program | 37 | 37 |
| Accrued payroll | 14 | 16 |
| Other accrued expenses | 21 | 14 |

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| | | |
|---|-------|-------|
| Share-based compensation | 13 | 17 |
| Others | 2 | 1 |
| Valuation allowance | (123) | (107) |
| Total deferred tax assets | 406 | 505 |
| Deferred tax liabilities: | | |
| Favorable lease, building and land use rights-fair value adjustment | 399 | 447 |
| Capitalized interest | 3 | 3 |
| Unrealized gain for investment | 7 | 7 |
| Others | 13 | 18 |
| Total deferred tax liabilities | 422 | 475 |

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For the years ended December 31, 2017 and 2018, valuation allowance of RMB60 and RMB36 were provided, respectively, RMB3 and nil were added due to acquisition, respectively, RMB47 and RMB43 were reversed, respectively, and RMB8 and RMB9 were written off, respectively. The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will more likely than not be realized. This assessment considers, among other matters, the nature, frequency and severity of recent losses, forecasts of future profitability, the duration of statutory carryforward periods, the Group's experience with tax attributes expiring unused and tax planning alternatives. Valuation allowances have been established for deferred tax assets based on a more likely than not threshold. The Group's ability to realize deferred tax assets depends on its ability to generate sufficient taxable income within the carryforward periods provided for in the tax law.

As of December 31, 2018, the Group had tax loss carryforwards of RMB722, which will expire between 2019 and 2023 if not used.

The Group determines whether or not a tax position is more-likely-than-not of being sustained upon audit based solely on the technical merits of the position. At December 31, 2017 and 2018, the Group had recorded liabilities for uncertain tax benefit of approximately RMB26 and RMB14 associated with the interests on intercompany loans, respectively. No interest or penalty expense was recorded for the years ended December 31, 2016, 2017 and 2018. The Group does not anticipate any significant changes to its liability for unrecognized tax benefits within the next 12 months.

| | Years Ended December 31, | | |
|----------------------------|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| Balance at January 1 | 15 | 20 | 26 |
| Addition for tax positions | 5 | 6 | (12) |
| Balance at December 31 | 20 | 26 | 14 |

In accordance with the EIT Law, dividends, which arise from profits of foreign invested enterprises (FIEs) earned after January 1, 2008, are subject to a 10% withholding income tax. If there is a favorable tax treaty between mainland China and the jurisdiction of the foreign holding company, the income tax rate may be reduced. For example, holding companies in Hong Kong that are also tax residents in Hong Kong are eligible for a 5% withholding tax on dividends under the Tax Memorandum between China and the Hong Kong Special Administrative Region if the holding company is the beneficial owner of the dividends. Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis in a domestic subsidiary. In 2018, the Group revised its dividend policy, and going forward the Group plans to maintain a moderate dividend distribution of approximately US\$100 million a year from current year net income starting from 2018. In 2018, to facilitate the Company's declaration of a cash dividend, PRC dividend withholding tax of RMB34 was accrued. As of December 31, 2018, the accrued PRC dividend withholding tax liability ending balance was RMB18. Other than these dividends distributions, the Group intends to indefinitely reinvest the remaining undistributed earnings of the Group's PRC subsidiaries, and therefore, no additional provision for PRC dividend withholding tax was accrued.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of income taxes is due to computational errors made by the taxpayer. The statute of limitations will be extended to five years under special circumstances, which are not clearly defined, but an underpayment of income tax liability exceeding RMB0.1 is specifically listed as a special circumstance. In the case of a transfer pricing related adjustment, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. The Group's PRC subsidiaries are therefore subject to examination by the PRC tax authorities from 2014 through 2018 on non-transfer pricing matters, and from 2009 through 2018 on transfer pricing matters.

Table of Contents**17. MAINLAND CHINA CONTRIBUTION PLAN**

Full time employees of the Group in the PRC participate in a government-mandated defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. PRC labor regulations require the Group to accrue for these benefits based on a certain percentage of the employees' salaries. The total contribution for such employee benefits were RMB213, RMB264 and RMB321 for the years ended December 31, 2016, 2017 and 2018, respectively. The Group has no ongoing obligation to its employees subsequent to its contributions to the PRC plan.

18. RESTRICTED NET ASSETS

Pursuant to laws applicable to entities incorporated in the PRC, the subsidiaries of the Group in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires annual appropriation of 10% of after tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of their registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for specific purposes of offsetting future losses, enterprise expansion and staff bonus and welfare and are not distributable as cash dividends and amounted to RMB277, RMB379 and RMB502 as of December 31, 2016, 2017 and 2018, respectively. In addition, due to restrictions on the distribution of share capital from the Company's PRC subsidiaries, the PRC subsidiaries share capital of RMB2,777 at December 31, 2018 is considered restricted. As a result of these PRC laws and regulations, as of December 31, 2018, approximately RMB3,279 is not available for distribution to the Company by its PRC subsidiaries in the form of dividends, loans or advances.

19. RELATED PARTY TRANSACTIONS AND BALANCES

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operational decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

The following entities are considered to be related parties to the Group. The related parties mainly act as service providers and service recipients to the Group. The Group is not obligated to provide any type of financial support to these related parties.

| Related Party | Nature of the Party | Relationship with the Group |
|--|---------------------------------|--|
| Ctrip.com International, Ltd. (Ctrip) | Online travel services provider | Mr. Qi Ji is a director |
| Sheen Star Group Limited (Sheen Star) | Investment holding company | Equity method investee of the Group, controlled by Mr. Qi Ji |
| Accor Hotels (Accor) | Hotel Group | Shareholder of the Group |
| China Cjia Group Limited (Cjia Group) | Apartment Management Group | Equity method investee of the Group |
| Shanghai CREATER Industrial Co., Ltd. (CREATER) | Staged office space company | Equity method investee of the Group |
| Shenzhen Hanmo Investment Fund Partnership LLP (Hanmo) | Hotel related fund | Equity method investee of the Group |

Table of Contents*(a) Related party balances*

Amounts due from related parties were mainly comprised of shareholder loans to Sheen Star, CREATER, Cjia Group, and Hanmo, which are short-term in nature and mainly payable on demand, and receivable for service fee from Accor, service fee and room charges withheld by Ctrip.

| | As of December 31, | |
|------------|--------------------|------|
| | 2017 | 2018 |
| Sheen Star | 39 | 44 |
| CREATER | 27 | 40 |
| Ctrip | 32 | 34 |
| Cjia Group | 15 | 23 |
| Hanmo | | 22 |
| Accor | 2 | 2 |
| Others | 3 | 11 |
| Total | 118 | 176 |

Amounts due to related parties were mainly comprised of payables for brand use fee, reservation fee and other service fee to Ctrip, and Accor, and cash received on behalf of Cjia Group and China Hospitality JV, which are short-term in nature and payable on demand.

| | As of December 31, | |
|----------------------|--------------------|------|
| | 2017 | 2018 |
| Ctrip | 29 | 25 |
| China Hospitality JV | | 25 |
| Accor | 7 | 8 |
| Cjia Group | | 7 |
| Others | 1 | 10 |
| Total | 37 | 75 |

(b) Related party transactions

During the years ended December 31, 2016, 2017 and 2018, significant related party transactions were as follows:

| | Years Ended December 31, | | |
|---|--------------------------|------|------|
| | 2016 | 2017 | 2018 |
| Commission expenses to Ctrip | 44 | 77 | 61 |
| Lease expenses to Ctrip | | | 18 |
| Brand use fee, reservation fee and other related service fee to Accor | 6 | 11 | 18 |
| Marketing and training fee from Ctrip | 13 | 24 | 12 |
| Service fee from Accor | 4 | 8 | 14 |
| Service fee from China Hospitality JV | | | 10 |
| Service fee from Sheen Star | | | 2 |
| Goods sold and service provided to Cjia Group | 0 | 8 | 30 |

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| | | | |
|---------------------------------|----|----|-----|
| Interest income from Sheen Star | 2 | | |
| Interest income from Hanmo | | | 7 |
| Interest income from CREATER | | | 10 |
| Loan payment to Sheen Star | 35 | | |
| Loan payment to Cjia Group | | 85 | |
| Loan payment to CREATER | | 27 | |
| Loan from Cjia Group | | | 103 |

In 2016, the Group sold its subsidiary Chengjia Hotel Management Co., Ltd. to Cjia for consideration of RMB10.

Table of Contents**20. COMMITMENTS AND CONTINGENCIES***(a) Operating lease commitments*

The Group has entered into lease agreements for certain hotels which it operates. Such leases are classified as operating leases.

Future minimum lease payments under non-cancellable operating lease agreements at December 31, 2018 were as follows:

| Year Ending December 31, | |
|---------------------------------|---------------|
| 2019 | 2,854 |
| 2020 | 2,863 |
| 2021 | 2,777 |
| 2022 | 2,661 |
| 2023 | 2,548 |
| Thereafter | 15,669 |
| Total | 29,372 |

(b) Purchase Commitments

As of December 31, 2018, the Group's commitments related to leasehold improvements and installation of equipment for hotel operations was RMB91, which is expected to be incurred within one year.

(c) Contingencies

The Group is subject to periodic legal or administrative proceedings in the ordinary course of our business. As of December 31, 2016, the Group had several cases outstanding, including lease contract terminations and disputes, and construction contract disputes. The Group believed it was probable that settlement liabilities would be involved, and therefore accrued contingencies of RMB66 in other operating expense based on the terms of contract, laws and regulations and latest negotiation result. For the year ended December 31, 2017, the Group had settled several cases and undergoes new cases. Therefore, the Group reversed contingencies of RMB36 and further accrued RMB11 based on latest negotiation or arbitration result with the remaining accrued contingencies of RMB41. For the year ended December 31, 2018, the Group had settled several cases and undergoes new cases. Therefore, the Group reversed contingencies of RMB25 and further accrued RMB4 based on latest negotiation or arbitration result with the remaining accrued contingencies of RMB20. The Group does not believe that any other currently pending legal or administrative proceeding to which the Group is a party will have a material adverse effect on the financial statements.

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ADDITIONAL FINANCIAL INFORMATION FINANCIAL STATEMENTS SCHEDULE I

HUAZHU GROUP LIMITED

FINANCIAL INFORMATION FOR PARENT COMPANY

BALANCE SHEETS

(Renminbi in millions , except share and per share data , unless otherwise stated)

| | 2017 | As of December 31, 2018 | 2018 US\$ million |
|---|--------|----------------------------|----------------------|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | 557 | 695 | 101 |
| Short-term investments | 130 | 89 | 13 |
| Other current assets | 37 | 29 | 4 |
| Total current assets | 724 | 813 | 118 |
| Other assets | 33 | 11 | 2 |
| Investment in subsidiaries | 10,062 | 13,454 | 1,957 |
| Long-term investments | 780 | | |
| Total assets | 11,599 | 14,278 | 2,077 |
| Liabilities and equity | | | |
| Current liabilities: | | | |
| Short-term debt | 131 | | |
| Dividends payable | | 658 | 96 |
| Amount due to related parties | 313 | 477 | 69 |
| Accrued expenses and other current liabilities | 35 | 54 | 8 |
| Total current liabilities | 479 | 1,189 | 173 |
| Long-term debt | 4,922 | 6,915 | 1,006 |
| Total liabilities | 5,401 | 8,104 | 1,179 |
| Equity: | | | |
| Ordinary shares(US\$0.0001 par value per share; 8,000,000,000 shares authorized; 294,040,234 and 296,597,888 shares issued as of December 31, 2017 and 2018, and 280,518,358 and 283,076,012 shares outstanding as of December 31, 2017 and 2018, respectively) | 0 | 0 | 0 |
| Treasury shares (3,096,764 and 3,096,764 shares as of December 31 2017 and 2018, respectively) | (107) | (107) | (16) |
| Additional paid-in capital | 3,624 | 3,713 | 540 |
| Retained earnings | 2,513 | 2,610 | 380 |
| Accumulated other comprehensive income (loss) | 168 | (42) | (6) |
| Total equity | 6,198 | 6,174 | 898 |
| Total liabilities and equity | 11,599 | 14,278 | 2,077 |

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**ADDITIONAL FINANCIAL INFORMATION FINANCIAL STATEMENTS SCHEDULE I
HUAZHU GROUP LIMITED
FINANCIAL INFORMATION FOR PARENT COMPANY**

**STATEMENTS OF COMPREHENSIVE INCOME
(Renminbi in millions, unless otherwise stated)**

| | 2016 | Years Ended December 31, | | 2018 US\$ million |
|--|------|--------------------------|-------|----------------------|
| | | 2017 | 2018 | |
| Operating costs and expenses: | | | | |
| General and administrative expenses | 60 | 69 | 89 | 13 |
| Total operating costs and expenses | 60 | 69 | 89 | 13 |
| Loss from operations | (60) | (69) | (89) | (13) |
| Interest income | 0 | 2 | 1 | 0 |
| Interest expense | 10 | 87 | 198 | 29 |
| Foreign exchange gain (loss) | 15 | (14) | 17 | 2 |
| Other income, net | 70 | 7 | 50 | 7 |
| Unrealized gain (loss) from fair value changes of equity securities | | 35 | (45) | (6) |
| Income in investment in subsidiaries | 767 | 1,354 | 980 | 143 |
| Net income attributable to Huazhu Group Limited | 782 | 1,228 | 716 | 104 |
| Other comprehensive income | | | | |
| Unrealized securities holding gains (losses), net of tax of (2), (8) and nil for 2016, 2017 and 2018, respectively | 16 | 1 | | |
| Reclassification of realized gains to net income, net of tax | (68) | (5) | | |
| Foreign currency translation adjustments, net of tax of nil for 2016, 2017 and 2018, respectively | (13) | 177 | (169) | (25) |
| Comprehensive income | 717 | 1,401 | 547 | 79 |

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**ADDITIONAL FINANCIAL INFORMATION FINANCIAL STATEMENTS SCHEDULE I
HUAZHU GROUP LIMITED
FINANCIAL INFORMATION FOR PARENT COMPANY**

**STATEMENTS OF CASH FLOWS
(Renminbi in millions, unless otherwise stated)**

| | 2016 | Years Ended December 31, | | 2018 |
|---|-------|--------------------------|---------|----------------------|
| | | 2017 | 2018 | 2018 US\$ million |
| Operating activities: | | | | |
| Net income | 782 | 1,228 | 716 | 104 |
| Adjustments to reconcile net income to net cash used in operating activities: | | | | |
| Share-based compensation | 55 | 66 | 83 | 12 |
| Income in investment in subsidiaries | (767) | (1,354) | (980) | (143) |
| Investment (income) loss | (51) | (41) | 46 | 7 |
| Amortization of issuance cost of convertible notes | | 3 | 28 | 4 |
| Changes in operating assets and liabilities: | | | | |
| Other current assets | 1 | (26) | 8 | 1 |
| Other assets | | (33) | 21 | 3 |
| Accrued expenses and other current liabilities | (17) | 26 | 18 | 3 |
| Net cash provided by (used in) operating activities | 3 | (131) | (60) | (9) |
| Investing activities: | | | | |
| Investment in subsidiaries | | (3,250) | | |
| Receipt of investment in subsidiaries | 236 | | 2,121 | 309 |
| Purchase of long-term investments | (48) | (760) | (3,782) | (550) |
| Proceeds from sale of long-term investments | 4 | 58 | | |
| Purchase of short-term investments | | (96) | | |
| Proceeds from sale of short-term investment | 337 | | | |
| Net cash provided by (used in) investing activities | 529 | (4,048) | (1,661) | (241) |
| Financing activities: | | | | |
| Net proceeds from issuance of ordinary shares upon exercise of option | 12 | 9 | 14 | 2 |
| Proceeds of advances from subsidiaries | 0 | 90 | 149 | 22 |
| Proceeds from short-term bank borrowings | 282 | 136 | | |
| Repayment of short-term bank borrowings | (333) | (294) | (128) | (19) |
| Proceeds from long-term bank borrowings | | 3,633 | 2,409 | 350 |
| Repayment of long-term bank borrowings | | (1,651) | (786) | (114) |
| Proceeds from issuance of convertible senior notes, net of issuance cost and capped call option | | 2,925 | | |
| Debt financing costs paid | | (10) | | |
| Proceeds from ADS lending | | 0 | | |
| Dividends paid | (276) | (306) | | |
| Net cash (used in) provided by financing activities | (315) | 4,532 | 1,658 | 241 |
| Effect of exchange rate changes on cash and cash equivalents | 36 | (170) | 201 | 29 |
| Net increase in cash and cash equivalents, and restricted cash | 253 | 183 | 138 | 20 |
| Cash, cash equivalents and restricted cash at the beginning of the year | 121 | 374 | 557 | 81 |
| Cash, cash equivalents and restricted cash at the end of the year | 374 | 557 | 695 | 101 |

The accompanying notes are an integral part of these consolidated financial statements

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**ADDITIONAL FINANCIAL INFORMATION FINANCIAL STATEMENTS SCHEDULE I
HUAZHU GROUP LIMITED
FINANCIAL INFORMATION FOR PARENT COMPANY**

Note to Schedule I

Schedule I has been provided pursuant to the requirements of Rule 12-04(a) and 5-04-(c) of Regulation S-X, which require condensed financial information as to the financial position, change in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

The condensed financial information has been prepared using the same accounting policies as set out in the accompanying consolidated financial statements except that the equity method has been used to account for investments in its subsidiaries. Such investments in subsidiaries are presented on the balance sheets as investment in subsidiaries and the profit of the subsidiaries is presented as income in investment in subsidiaries.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The footnote disclosures contain supplemental information relating to the operations of the Company and, as such, these statements should be read in conjunction with the notes to the accompanying consolidated financial statements.

As of December 31, 2018, there are no material contingencies, mandatory dividend, and significant provision of long-term obligation or guarantee of the Company, except for those which have separately disclosed in the consolidated financial statements.

Table of Contents**ADDITION INFORMATION FINANCIAL STATEMENTS SCHEDULE II****HUAZHU GROUP LIMITED**

This financial information has been prepared in conformity with accounting principles generally accepted in the United States.

VALUATION AND QUALIFYING ACCOUNTS

| | Balance at Beginning of Year | Charge to Costs and Expenses | Addition Due to Acquisition (Renminbi in millions) | Charge Taken Against Allowance | Write off | Balance at End of Year |
|--|---|---|---|---|------------------|-----------------------------------|
| Allowance for doubtful accounts of accounts receivables and other receivables: | | | | | | |
| 2016 | 6 | 1 | 7 | | (2) | 12 |
| 2017 | 12 | 2 | | | (3) | 11 |
| 2018 | 11 | 10 | 4 | | (8) | 17 |
| Valuation allowance for deferred tax assets | | | | | | |
| 2016 | 93 | 55 | 12 | (17) | (28) | 115 |
| 2017 | 115 | 60 | 3 | (47) | (8) | 123 |
| 2018 | 123 | 36 | | (43) | (9) | 107 |
