

European hotels bounce back

Following our review of the UK listed hotel sector last week we are taking a closer look at PPHE Hotel Group. This is a small cap company with family interests owning 64% of the shares which makes it illiquid. Factoring this in and the valuation still appears modest and as such we rate the shares as a high risk buy.

The world's largest hotel group by the number of rooms, Intercontinental Hotels Group (IHG), reported results earlier this week. These showed that revenue per available room (RevPar) grew by 6.1% in 2014.

This was driven by a rate gain of 2.7% an occupancy gain of 2.2% with the Americas the strongest region. Europe was the next strongest region with RevPar growth of 5.1% which outstripped the two other regions.

IHG Revenue per available room (RevPar) in 2014

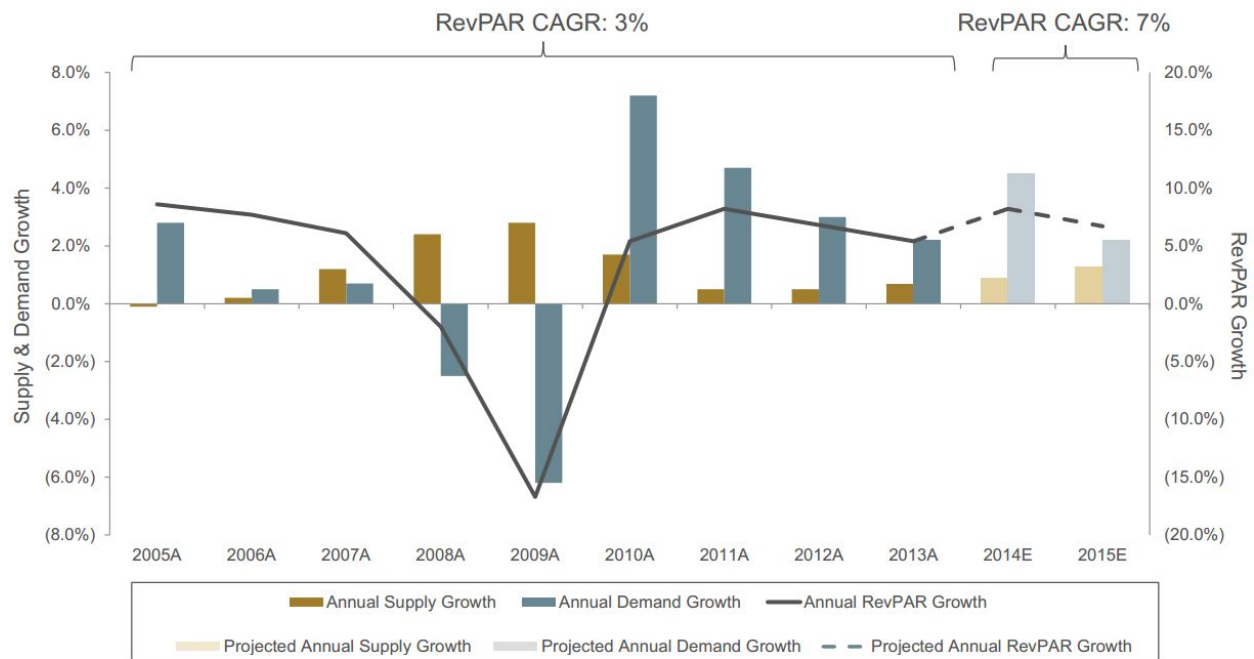
	Full Year 2014		
	RevPAR	Rate	Occ.
Group	6.1%	2.7%	2.2pts
Americas	7.4%	3.7%	2.4pts
Europe	5.1%	2.3%	1.9pts
AMEA	3.8%	2.4%	1.0pts
G. China	1.6%	(2.3)%	2.4pts

Source: IHG full year results announcement

The global backdrop is therefore reasonably positive for the hotel industry as occupancy and room rates both improve. The UK has six listed hotel groups with a market value over £60m while the largest listed European group is Accor.

The Hotel Sector Cycle: The US Hotel Industry since 2005

Industry forecasts predict continued low hotel supply growth. Given low levels of new supply, U.S. industry RevPAR is expected to grow at a CAGR of more than 7% from 2013 to 2015



Source: Hilton Hotel Group

IHG Share price since 2005 (the group's main exposure is the US)



Two interesting hotel groups: PPHE Hotel Group & Dalata Hotel Group

The review of the London listed hotel sector last week suggested that the larger two groups – IHG and Millennium & Copthorne – are fairly valued. This is not to say that they won't outperform if a medium to long-term view is taken.

The two smaller groups – easyHotel and Action Hotels – are at an early stage of their development. The performance of small foreign operated groups listed in London has generally been poor and as such we are cautious on Action Hotels.

Evaluating the valuation against medium-term prospects and the two remaining companies appear attractive. Dalata Hotel Group provides exposure to the Irish recovery and PPHE Hotel Group provides exposure to the UK & Europe.

Dalata Hotel Group (market value £326m): playing the Irish recovery

Dalata was listed in March 2014 on both the Irish and London stock exchanges and appears somewhat illiquid. Since listing the company has undertaken a series of acquisitions and raised a further €16.8m in cash in December.

According to estimates the group now has 9% of the Irish hotel market and is three times larger than its next largest competitor. In Dublin the position is even stronger with an estimated market share at 18%.

Dalata's leading position in Ireland

Leading Irish Hotel Operators

Operator	No. Hotels	No. Rooms	% Share
Dalata	36	5,414	9.4%
Carlson Rezidor	11	1,665	2.9%
Bewley Moran	6	1,656	2.9%
Tifco	10	1,369	2.4%
Hilton	5	1,172	2.0%
Choice Hotels	6	1,130	2.0%
Total (Top 6)	74	12,406	21.6%
<i>Total (Republic of Ireland)</i>	<i>835</i>	<i>57,362</i>	<i>100.0%</i>

Source: AMPM Database, Company estimates

Source: Dalata interim results presentation

The Irish Hotel market hots up

Irish Market Performance

A 10% increase in visitor numbers (Jan to Jul 2014) and continued improvement in domestic economy is delivering higher RevPars in Irish City Markets

	RevPar Growth 2013	RevPar Growth YTD July/Aug 2014
Dublin	11.2%	8.7% (Jul)
Belfast	7.2%	10.4% (Jul)
Cork	8.3%	9.2% (Aug)
Galway	2.1%	7.6% (Aug)
Limerick	3.9%	14.4% (Aug)

Source: Dalata interim results presentation

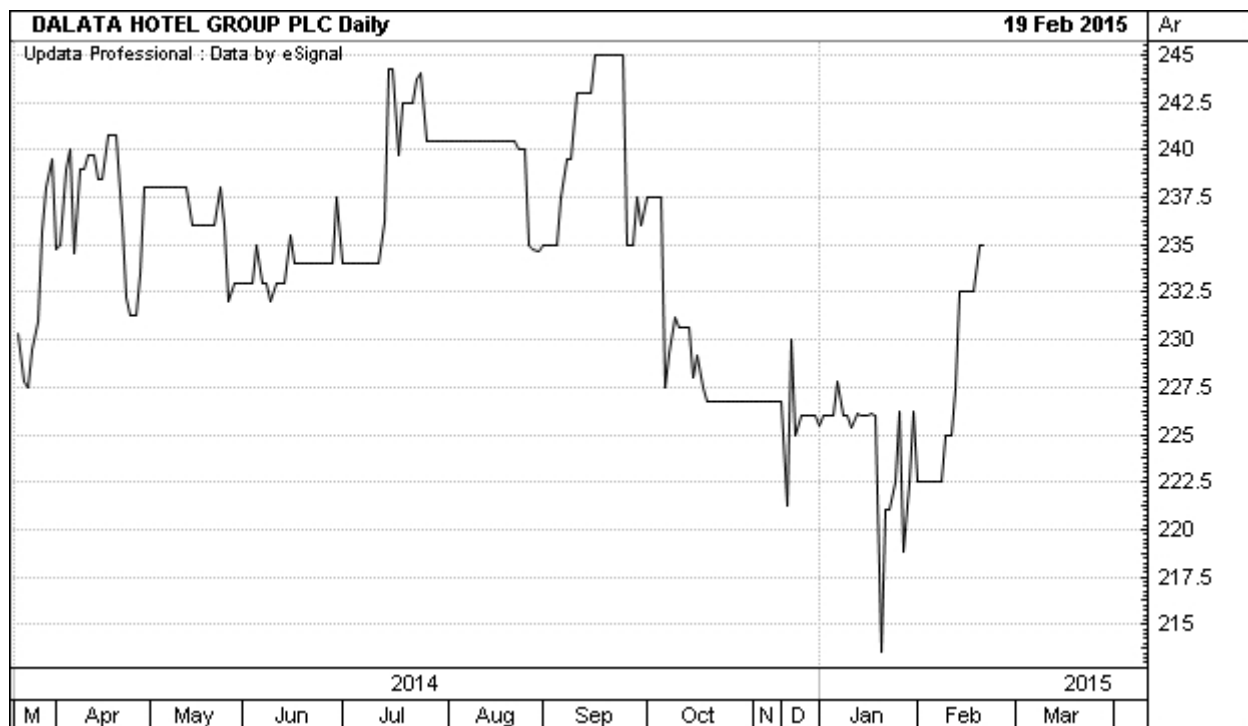
Dalata owns 40% of its operating 7,400 operating hotel rooms and saw a robust performance in the first half. Revenue per available room increased by 11.4% despite a 0.5% fall in occupancy due to refurbishments.

What is interesting about Dalata is that the CEO was previously in the same position at Jurys Doyle Hotel Group. As such the company should have a strong management team with solid experience.

The admission document, interim financial results and interim results presentation are all on the Dalata website. The largest acquisition to date has been Moran Bewley's Hotel Group for €455m which completed this month.

In our view, Dalata Hotel Group is worth evaluating more closely with it appearing to have positive medium-term prospects. We have opted to firstly look at PPHE Hotel Group, though, due to its longer trading history as a public company.

Dalata share price since listing



PPHE Group(market value £200m): Set for record results

PPHE Hotel Group listed in London just before the financial crisis started in July 2007. However, the share price has nearly recovered to where it started trading after its IPO at 490p which suggests that the business has been resilient.

The group has been operating since 1989 and is focused on the “affordable luxury” end of the hotel market. In 2013 approximately 65% of revenue was generated from the UK.

PPHE Hotel Group at June 2014

- Well-established owner, developer, operator and franchisor of hotels
- Main market listed, operating since 1989 and focused on the expanding "affordable luxury" market
- 38 owned, leased, operated and franchised hotels and apartment complexes in EMEA
- Focus on major gateway cities including London, Amsterdam and Berlin
- Six countries, over 2,500 employees



Source: PPHE investor presentation

The UK generated the bulk of revenue and profits in 2013

Source: PPHE investor presentation

Ownership and management

The first factor to consider is the ownership structure with Chairman Eli Papouchado's family interests at 44.63% of the voting rights. CEO and President Bovis Ivesha's family interests have 19.25% of the voting rights.

Shares at end of 2013: Red Sea (Mr Papouchado), Molento (Mr Ivesha)

Number of issued shares	43,377,292	
<i>Held in treasury by PPHE Hotel Group</i>	<i>1,862,000</i>	
<i>Number of issued shares (excluding treasury)</i>	41,515,292	
Largest shareholders	Number of shares	Percentage of issued share capital (excluding treasury)
<i>Red Sea Group¹</i>	<i>18,552,714</i>	<i>44.69%</i>
<i>Molteno Limited¹</i>	<i>7,990,027</i>	<i>19.25%</i>
Total Red Sea Group and Molteno Limited	26,542,741	63.94%

¹ Mr Papouchado, the Chairman, is deemed interested in the shares held by the Red Sea Group and Mr Ivesha, the CEO, is deemed interested in shares held by Molteno Limited

Source: investor presentation

NB: By way of comparison shares in admission at the IPO in 2007 were 40.94m.

The two interests are assumed to act in concert (together) which means an effective controlling stake at 64%. This creates liquidity issues in terms of buying shares and also potential corporate governance issues.

Both Mr Papouchado (76) and Mr Ivesha (68) have had long careers in the hotel and hospitality industry. Mr Papouchado served as Chairman of the Israel Hotels Association and Mr Ivesha has been President of PPHE Hotel Group since 1991.

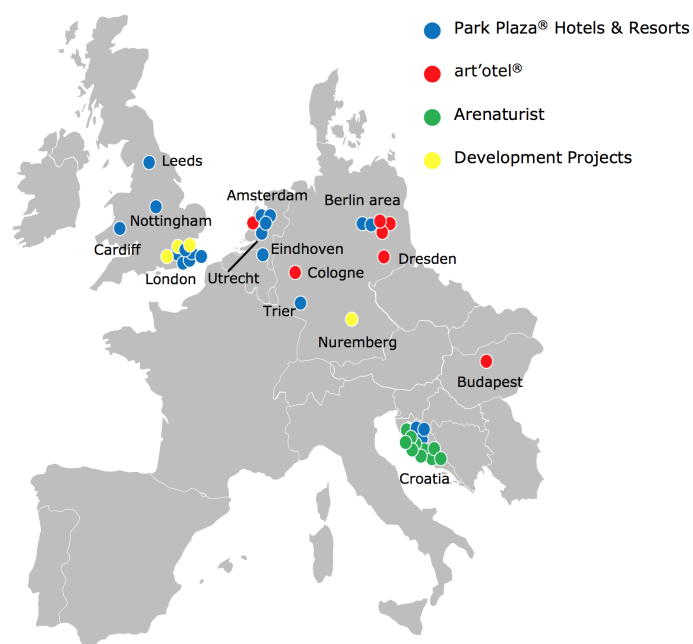
We note that Guy Ivesha, the son of the CEO, is also on the executive board which is a potential governance issue. Family companies often outperform but if they aren't meritocratic this is likely to be a handicap.

PPHE Hotel Group 101

Turning to the business itself and PPHE Hotel Group appears to be in strong shape and with solid near-term prospects. Both the interim and final dividend have recently been increased from their base levels of 6p a share each.

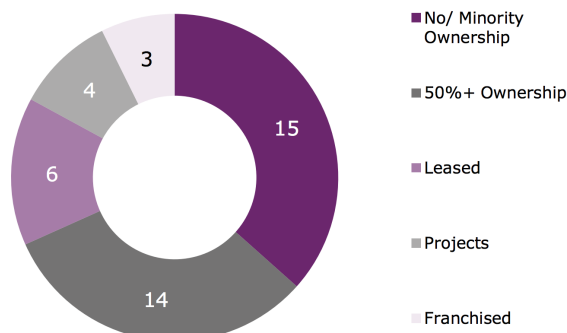
PPHE Hotel Group portfolio

Hotel locations



Source: PPHE Hotel Group
Note: Location map does not include hotels outside of EMEA

Contract mix



Source: PPHE Investor presentation

PPHE Development Pipeline

Project	Location	Operating structure	No of rooms	Status
Park Plaza Belvedere Medulin ¹	Medulin, Croatia	Co-owned and management contract	427	Opened on time June 2014
Park Plaza Nuremberg	Nuremberg, Germany	Owned and management contract	177	Expected to open 2015
Park Plaza Riverbank London extension and reconfiguration	London, United Kingdom	Owned and management contract	98	Expected to open 2015
Park Royal London project	London, United Kingdom	Owned and management contract	158	Expected to open 2015
Waterloo Station London project	London, United Kingdom	Owned and management contract	438	Expected to open 2016
art'otel london hoxton	London, United Kingdom	Joint venture and management contract	352	Expected to open 2017

Source: PPHE Investor presentation

The map of PPHE's locations appears to suggest that it is a diversified European group when actually 65% of revenue in 2013 was from the UK. This proportion should increase over time with four UK hotels set to open from 2015 to 2017.

The company reports in euros and as such the value of sterling against the euro reflects the reported results. As such foreign exchange was a results headwind for reported results in 2013 but will be a tailwind in both 2014 and 2015.

Sterling against the euro from 2012

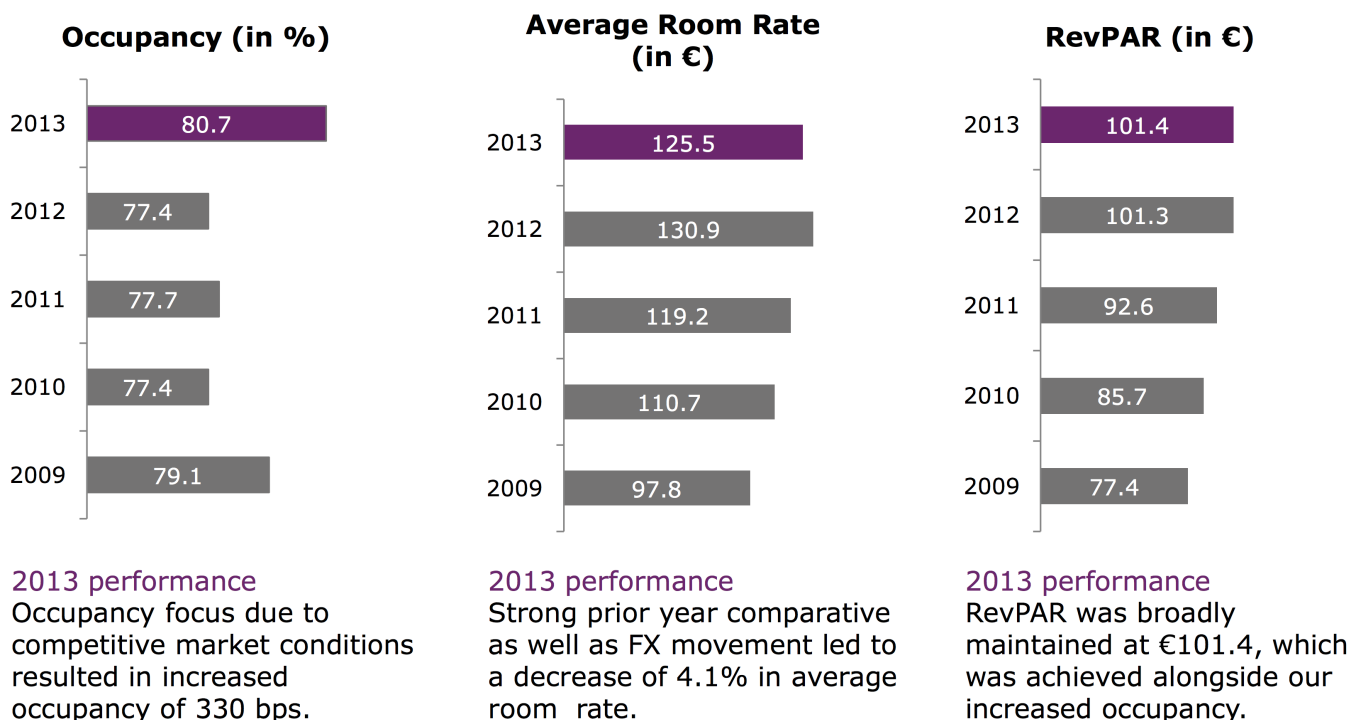


For UK investors the reality is that the strength of sterling against the euro is actually a headwind. This is because it reduces the value of profits earned in the eurozone in sterling terms although it may attract more visitors to the eurozone.

Operating statistics

The recovery in the UK and Europe drove hotel occupancy at PPHE to 80.7% in 2013 which compares to less than 78% from 2010 to 2012. The average room rate fell from €130.9 to €125.5 due to a strong comparative and an FX headwind.

PPHE sees an improving hotel performance



Trading in 2014: expectations beaten

The net result was that revenue per available room was flat in 2013 but has started to pickup in 2014. H1 results in 2014 saw occupancy pickup by 2.5% on a year ago to 80.3% and the average room rate rose by 8.7% to €132.5.

The room rate strength was as sterling was a tailwind in the period (strengthening against the euro) and stronger trading conditions. The net result was a robust 12.3% increase in the average room rate to €106.5.

PPHE first half 2014 results

	Reported ⁴		
	Six months ended 30 June 2014	Six months ended 30 June 2013	% change ³
Total revenue	€125.4 million	€111.6 million	+12.3%
Room revenue	€84.9 million	€78.0 million	+8.9%
EBITDAR	€45.3 million	€41.3 million	+9.7%
EBITDA	€39.7 million	€35.7 million	+11.1%
EBITDA margin	31.7%	32.0%	(30) bps
Reported PBT	€19.2 million	€9.3 million	+106.3%
Normalised PBT ¹	€7.7 million	€5.0 million	+54.8%
Occupancy	80.3%	77.8%	+250 bps
Average room rate	€132.5	€122.0	+8.7%
RevPAR	€106.5	€94.8	+12.3%

Source: PPHE website

Momentum continued in the third quarter with occupancy at 89.8% from 87.8% last year and the average room rate up 8.9% to €137.5. As such the revenue per available room in Q3 was up 11.4% on last year to €123.5.

The fourth quarter is the key trading period and in an update in December the group revealed that it has been “very strong.” As such results for the 2014 financial year are expected to be above the board’s previous expectations.

The view from one of PPHE’s London hotels



Source: PPHE website

Balance sheet risks

Despite having a mixed strategy of part ownership, management contracts and full ownership the level of debt is high. Net debt at the end of 2013 was €483m and increased by €22.3m during the year.

The gearing ratio is defined as the net debt as a percentage of total capital which is equity (adjusted for the hedging reserve) plus net debt. This improved by 0.6% during 2013 to end the year at 61.4% and at mid-2014 was 59.4%.

Improved trading conditions don't make debt a near-term risk but in a downturn over expansion can bankrupt a business like this. As such the gearing and the affordability of interest payments is something we will closely watch.

Balance Sheet

	2013 €'000	2012 €'000	Change %
<i>Assets</i>			
Non-Current Assets	1,054,242	1,014,070	4.0%
Current Assets	70,025	95,489	-26.7%
Total Assets	1,124,267	1,109,559	1.3%
Total Equity	290,565	259,897	11.8%
<i>Liabilities</i>			
Non-Current Liabilities	763,333	752,065	1.5%
Current Liabilities	70,369	97,597	-27.9%
Total Equity & Liabilities	1,124,267	1,109,559	1.3%

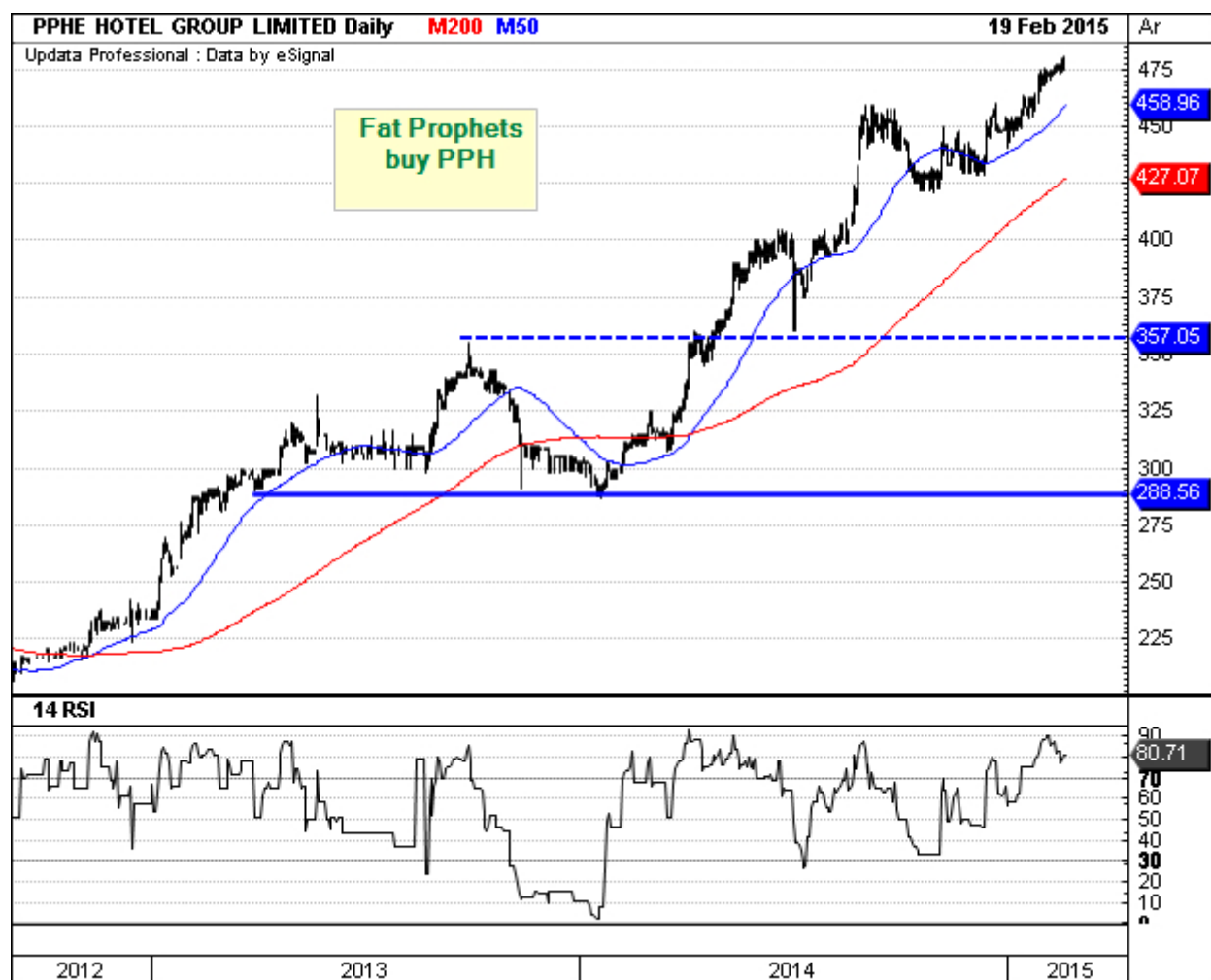
Source: PPHE investor presentation

Valuation

On an earnings basis PPHE Hotel Group is not expensive on around 9X forecast profits for 2014 and 2015. The yield is expected to come in at 3.2% in 2014 and increase to 3.5% in 2015 with over 3X profits cover in both years.

For 2016 the forecast P/E ratio comes in at 8.5X with a forecast yield at 4.5% which is expected to be 2.8X covered. The expansion of profits is at a faster rate than net debt and as such the risk profile should reduce in the medium-term.

The equity valuation (book value) was €290.6m at the end of 2013 and at mid-2014 came in at €306.3m. The mid-2014 figure is around £225m which is ahead of the current market value at around £200m.



The technical outlook is positive as the share price continues to trace out higher lows since the uptrend resumed in 2014. Furthermore, the recent break above the 50-day moving average is indicative of the strength of the current momentum, which bodes well. Even though the share price appears to be overbought (RSI 80.71) it can still unwind without much damage and continue its bull run.



Summary

Given the illiquidity of the shares it is not advisable to have a large position in the PPHE Hotels Group. The high debt position also makes the group vulnerable to a significant economic downturn.

However, the current trading position is strong and the group is valued below book value and at a modest P/E ratio. There is also a near-term pipeline of hotel openings with four of these in London and two in Europe.

At this stage of the economic cycle and indeed the cycle in the fortune of the hotel sector the prospects look strong. A weak point is the potential corporate governance issues but at the same time family groups often outperform.

Full year results will be announced on the 2nd of March and are likely to show an impressive performance. The trading momentum is set to continue into 2015 given Europe's economic recovery and the jobs recovery in the UK.

Accordingly, we recommend PPHE Hotel Group as a high risk buy to all members.

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Snapshot PPH

PPHE Hotel Group

Latest Closing Price: £4.80

PPHE Hotel Group Limited through its subsidiaries, jointly controlled entities and associates, owns, leases, operates, franchises and develops full service upscale and lifestyle hotels in cities and regional centers in Europe. The Company's activities are divided

into owned hotel operations and management activities. The majority of the Group's hotels operate under two brands, Park Plaza Hotels & Resorts and art'otel.

Market Capitalisation:£200m

	FY1	FY2
Price to Earnings	9.2	9.0
Dividend Yield (%)	3.1	3.5
Return on Equity (%)	9.1	8.8

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