

PPHE Hotel Group

Going places

Interim results

Travel & leisure

20 September 2017

Price 1,075p
Market cap £455m

Net debt (£m) at 30 June 2017 559.0
Shares in issue 42.3m
Free float 23%
Code PPH
Primary exchange LSE
Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	19.1	31.1	52.5
Rel (local)	19.8	35.0	41.9
52-week high/low	1075.0p		675.0p

Business description

PPHE Hotel Group (formerly Park Plaza Hotels) is an integrated owner and operator of four-star, boutique and deluxe hotels in gateway cities, regional centres and select resort destinations, predominantly in Europe.

Next events

IMS November 2017

Analysts

Richard Finch +44 (0)20 3077 5700
Paul Hickman +44 (0)20 3681 2501

consumer@edisongroup.com

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PPHE has arguably trumped its strong H117 results by highlighting its “unprecedented financial position,” which provides exciting scope for management with an enviable development record. Excess liquidity is substantial (we estimate £250+m cash after Waterloo sale backed by a valuation surplus) and its deployment is actively under review. Meanwhile impressive +23% H117 EBITDA despite headwinds and a positive outlook have led us to raise forecasts, if marginally. Heartland London recovered well, with key openings soon making their mark. A meagre rating belies PPHE’s proven profit delivery and asset backing (fair value c £18/share).

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	EV/EBITDA (x)
12/15	218.7	80.1	31.8	76.1	20.0	10.6
12/16	272.5	94.1	34.2	73.9	21.0**	11.1
12/17e	326.0	106.0	33.5	65.9	22.0	9.7
12/18e	350.0	113.0	40.0	78.5	23.0	8.8

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Plus 100p special dividend

H117: Busy and successful

The half saw strong underlying growth across the board (double-digit but for renovation impact in otherwise buoyant Netherlands). Admittedly, London, PPHE’s main profit centre, was flattered by a weak comparative after the Paris attacks (core London RevPAR up c 10% against down 5% in H116). By contrast, Croatia flourished with +19% like-for-like and sterling revenue up by a third in June, the only high-season month in the period. EBITDA progress was more uneven as core London (+c 15%) and Netherlands (local currency -8%) were curbed, respectively, by cost pressures (payroll and business rates) and renovation at the flagship Victoria Amsterdam. Whereas Croatia was down owing to first inclusion of loss-making Q1, Germany and Hungary EBITDA was boosted by lower rent after Berlin deals.

Holding firm

Our unchanged, broadly positive assumptions for this year and next allow a minor upgrade to forecasts, ie revenue and EBITDA, respectively, 3% and £4m in 2017 and 5% and £3m in 2018. As detailed on page 2, in London we see slower growth on more normal comparatives and persistent cost pressures (EBITDA margin down), sustained buoyancy in Croatia, renovation impact in the Netherlands and a positive first contribution from PP Waterloo and Park Royal, now fully operational. Despite caution ahead of its key trading period and uncertain times, we are buoyed by general momentum and payoff from recent transformative investments.

Valuation: Much more to come

Current record share price strength (up 28% since end July) looks at last to be starting to recognise PPHE’s investment case. Recent revaluation to include London openings accentuated the discount to real value (adjustment of c 1,340p/share to reported NAV, pre-Waterloo sale). At 8.8x 2018e EV/EBITDA, the rating is low against an average of c 10x 2018e for branded European peers.

Financials

Exhibit 1: Analysis of revenue and profit							
Year-end December (£m)	H116	H216	FY16	H117	H217e	FY17e	FY18e
Revenue							
UK							
London							
RevPAR	£118	£150	£135	£130	£154	£142	£145
Change	-5%	+4%	Flat	+10%	+3%	+5%	+3%
Available rooms	1,898	1,910*	1,904*	2,052*	2,052*	2,052*	2,082
Room revenue	41.0	52.8	93.8	48.2	58.1	106.3	110.0
Non-room revenue	20.5	22.5	43.0	22.5	23.2	45.7	46.5
Existing revenue	61.5	75.3	136.8	70.7	81.3	152.0	156.5
Waterloo + Park Royal**	-	0.4	0.4	9.8	14.2	24.0	33.5
Total London revenue	61.5	75.7	137.2	80.5	95.5	176.0	190.0
Leeds and Nottingham	4.9	6.6	11.5	5.1	6.9	12.0	12.0
UK	66.4	82.3	148.7	85.6	102.4	188.0	202.0
Netherlands (€m)	29.6	29.4	59.0	28.9	24.1***	53.0***	56.0***
Exchange rate	1.28	1.17	1.22	1.16	1.10	1.13	1.10
Netherlands	23.2	25.1	48.3	24.9	22.1	47.0	51.0
Croatia (HRKm)	92.1	331.0	423.1	125.2	344.8	470.0	486.0
Exchange rate	9.63	8.96	9.17	8.64	8.15	8.40	8.15
Croatia**	9.6	36.5	46.1	14.5	41.5	56.0	60.0
Germany and Hungary***	10.6	14.5	25.0	14.4	15.6	30.0	32.0
Owned & leased hotels	109.7	158.4	268.1	139.4	181.6	321.0	345.0
Management and holdings	1.8	2.6	4.4	2.4	2.6	5.0	5.0
TOTAL	111.6	160.9	272.5	141.8	184.2	326.0	350.0
EBITDA							
UK							
London							
Existing	20.3	29.4	49.7	23.4	28.4	51.8	51.5
Margin (%)	33	39	36	33	35	34	33
Waterloo + Park Royal*	-	(0.5)	(0.5)	1.8	3.4	5.2	9.0
Total London EBITDA	20.3	28.9	49.2	25.2	31.8	57.0	60.5
Leeds and Nottingham	0.7	1.2	1.9	0.8	1.2	2.0	2.0
UK	21.0	30.1	51.1	26.0	33.0	59.0	62.5
Netherlands (€m)	9.5	8.4	17.9	8.8	6.0	14.8	15.7
Exchange rate	1.28	1.17	1.22	1.16	1.10	1.13	1.10
Netherlands	7.4	7.2	14.6	7.5	5.5	13.0	14.3
Croatia (HRKm)	14.9	139.0	153.9	Neg.	152.0	152.0	160.0
Exchange rate	9.63	8.96	9.17	8.64	8.15	8.40	8.15
Croatia****	1.5	15.3	16.8	Neg.	18.0	18.0	19.5
Germany and Hungary*****	(0.8)	1.7	0.9	1.7	2.3	4.0	4.7
Owned & leased hotels	29.2	54.2	83.4	35.2	58.8	94.0	101.0
Management and holdings	3.3	7.4	10.7	4.7	7.3	12.0	12.0
TOTAL	32.5	61.6	94.1	39.9	66.1	106.0	113.0

Source: Edison Investment Research. Note: *Including Riverbank extension (184 rooms) from 12.16 and rooms off at Sherlock Holmes (est. 30). **December 2016 Waterloo 494 rooms + April 2017 Park Royal 212 rooms (fully operational by Q317). ***Rooms off in Amsterdam (notably Victoria H217 and H118). ****From April 2016. *****Including Nuremberg 177 rooms from June 2016.

H117: Business as usual

In the face of exceptional security challenges in its London heartland, PPHE showed remarkable resilience and focus to combine decent financials with active, uninterrupted implementation of a busy development schedule. This included a material addition (over 700 rooms) to the London portfolio (now c 3,150) with the openings of Park Plaza Waterloo and Park Royal (fully operational by period end) and participation in a transformative €106m fund-raising by its Croatian subsidiary, Arena Hospitality. There was also minor adjustment to the estate in Germany (acquisition of two

Berlin properties previously under operating leases) and the Netherlands (sale of part of Park Plaza Vondelpark Amsterdam). Last but not least, at the very end of the half, the company entered into a sale and leaseback agreement for Waterloo.

Strength in depth

Despite striking increases in H117 headline revenue and EBITDA of 27% and 23%, as shown in Exhibit 1, a lot of moving parts makes it incumbent to identify underlying performance. Therefore we begin by adjusting to omit recent openings in London and Germany, to include Croatia's pre-acquisition Q116 and to reflect the new freehold position of two Berlin hotels. These temper respective like-for-like advances to 16% and 21%. We make further revision for currency in view of sterling depreciation. Adjusting for this translation boost reduces revenue and EBITDA gains to 11% and 18%. This double-digit growth is still impressive and even more so as broadly spread, ie RevPAR up c 10% and 18% in London and Germany and Hungary, respectively, revenue +19% in Croatia and RevPAR up 4% in the Netherlands despite a strong comparative and renovation.

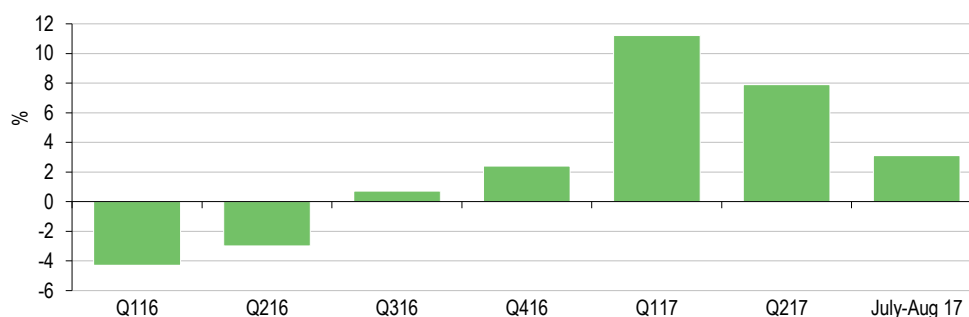
Exhibit 2: Analysis of underlying H117 revenue and EBITDA

€m	Revenue	H116	H117	EBITDA	H116	H117
Reported		111.6	141.9		32.5	39.9
Change			+27%			+23%
Like-for-like		111.9	129.6		31.5	38.0
Change			+16%			+21%
Currency boost*			(5.0)			(0.8)
Underlying			124.6			37.2
Change			+11%			+18%

Source: Edison Investment Research. Note: *H117 €1.16/£ (H116: €1.28/£); Croatian kuna – H117 HRK8.64/£ (H116: HRK9.63/£).

It barely needs pointing out that London's aforementioned apparent bumper performance should be seen against a half subdued by the November 2015 attacks in Paris when a 5% reduction in RevPAR was in line with market reports for the capital – see Exhibit 3. Moreover, the company's 10% yield gain in the period was no more than that of the market. However, it is much to the credit of London and PPHE that such positive recovery was achieved in the face of further major attacks (Westminster Bridge and London Bridge), especially given their proximity to the company's South Bank focus. Pound devaluation following the Brexit vote has provided a signal boost to tourism and thus the hotel sector. According to VisitBritain, visits to the UK were up 9% in H117. While arrivals from the EU (two-thirds of visits) saw a rise of 4%, there was notable demand from North America (up by a quarter) and the rest of the world (+18%).

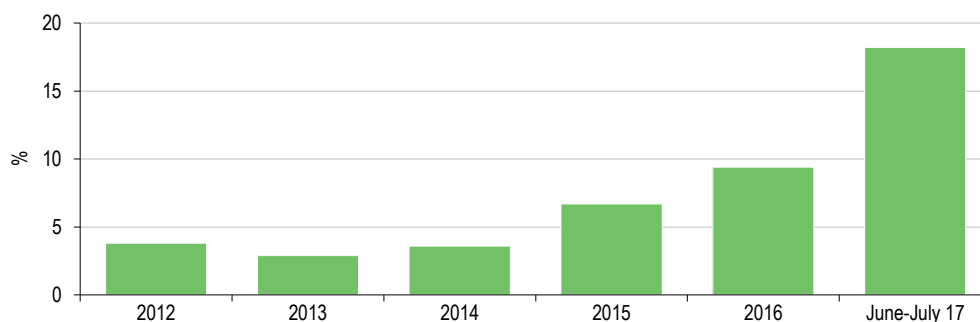
Exhibit 3: Changes in RevPAR in PPHE's key London market



Source: STR

While London may thus have been flattered in H1, the reverse applied to Croatia as its off-season Q1 was included for the first time and risks obscuring exceptional buoyancy (revenue +35%) in June, the first high-season month of the year. If Q116 is included for comparability, the increase in like-for-like local currency revenue was almost 20%. Q217 alone was up 25%, albeit boosted by a late Easter. As shown below, such progress reflects a step-change in the appeal of Croatia as a tourist destination in addition to payoff from the company's significant pre-season investment.

Exhibit 4: Annual growth in Croatia tourism (peak trading June-Sept foreign tourist nights)



Source: Croatian Bureau of Statistics

The performance in the Netherlands is similarly deserving of explanation as a reported decline in revenue, however minor (2%), is at odds with a business that has seen consistent growth. Fortunately this is simply attributable to renovation at the flagship Victoria Amsterdam and reduction in size of Vondelpark Amsterdam (we have assumed 50 rooms off or c 4% of total inventory). 4% RevPAR gain was respectable against a buoyant H116 (5% ahead).

Germany and Hungary were also somewhat out of kilter, with RevPAR up an exceptional 18% I-f-I in the period. This reflected recovery from a soft first half in 2016, depressed by renovations and market weakness.

Like-for-like notwithstanding, first signs from Waterloo and Park Royal openings were encouraging and Nuremberg, which opened in H116, looks to be maturing well. Waterloo in particular has filled up quickly, capitalising on the company's unique South Bank concentration and general market recovery. Park Royal, whose launch was delayed into Q2, has more the trading characteristics of a UK provincial hotel.

Challenging profit conversion

Although like-for-like EBITDA improvement of 18%, as discussed above, is per se no mean feat, such all-round buoyancy might have been expected to deliver yet higher returns by a business with such operational gearing. Total RevPAR gain was, after all, 18% I-f-I and room rate-led, albeit currency boosted.

However, the UK, much the company's principal profit centre, saw accelerating pressure on labour supply and operating costs as well as increased security expenses following recent attacks. In addition to a persistent hike in business rates, sterling weakness accounted for a rise in imported food costs and a shortage of qualified staff as remittances by migrant workers were no longer worth so much when sent to their families back home. Specifically, to show the scale of the challenge, management has commented on a shortage of 90 housekeeping personnel out of a team of 400, resulting in their payroll costs now somewhat ahead of national minimum wage rate. For the core London hotels, we have therefore assumed for H117 only maintained EBITDA margin despite double-digit top-line growth (EBITDA is disclosed only at country level).

By contrast, Croatia did indeed convert successfully. On a like-for-like basis, ie including pre-acquisition Q116, a 19% rise (HRK20m) in local currency revenue led to the elimination of HRK8m EBITDA loss.

The shortfall in Netherlands EBITDA was due simply to rooms off and associated disruption from renovation, as mentioned above. 2% lower local currency revenue resulted in an 8% decline in EBITDA, ie margin down from 32% to 30%.

Optimism maintained – minor upgrades in order

The outlook for the rest of this year and 2018 remains one of sustained underlying growth in all PPHE's operating regions. Most significantly, London may be expected to return to more normal levels, say +2-3% RevPAR. Geopolitical events, eg security and Brexit uncertainty, are necessarily a concern but the hotel market has shown admirable resilience and is a beneficiary of increased tourism as a result of sterling weakness. A greater measurable worry is room supply, which is set to rise above its long-term trend over the next year. Already market occupancy has fallen in each of the last three months, according to STR, even though demand continues to go up. Such was the impact in August of a spike in supply (4% against 2.7% in 2016 and 2.2% the year before) that the month's RevPAR was merely flat. In the light of this more modest revenue growth and persisting cost issues (labour and imported inflation) we expect further EBITDA margin erosion in London (excluding openings) in both H2 and next year.

Similar RevPAR growth to the UK levels is on the cards in the Netherlands but the renovation impact will intensify with up to 20% of inventory off; we have assumed 200 rooms off in the current half and 100 in 2018, predominantly at the 299-room Victoria Amsterdam. As a result, we forecast local currency H217 EBITDA down by almost 30% but recovering slightly next year on initial investment payoff.

Croatia is arguably the joker in the pack as our +3% RevPAR forecast for both periods seems cautious, given the company's flourishing June, enthusiasm about summer trading and the Croatian Bureau of Statistics' confirmation of market strength in July (foreign visitor nights up 11%, giving cumulative June-July +18%, as shown in Exhibit 3). We are also encouraged by likely returns from increased investment and extension of business, eg music festivals and sporting competitions, in the resort hotels' shoulder months.

We remain positive about the London openings, which achieved a better than expected 18% EBITDA margin in their initial half.

Given broadly unchanged assumptions, adjustments to forecasts for both periods are minor but positive at the revenue and EBITDA level, ie respectively 3% and £4m in 2017 and 5% and £3m in 2018.

The reduction in our PBT forecasts (£2.5m this year and £4m next) is due to higher depreciation than we had expected (likely up 35% this year, driven by the London openings) and finance costs inflated by Waterloo rent after the sale and leaseback. In any case EV/EBITDA remains our preferred valuation metric.

“Unprecedented financial position” shows PPHE on front foot

The June balance sheet confirmed finances to be in good shape. While net debt remains well within long-term bank facilities (average term to maturity of eight years), of particular note was record cash of c £190m, of which c £100m was in Arena after its public offering. To this should be added c £80m from the subsequent Waterloo sale and leaseback.

Last year the company recognised that after its extensive refinancings it had excess liquidity, so paid a special dividend of 100p, ie c £42m. By contrast, a repeat has now been formally deferred for 12 months.

It was thus no surprise that management has confirmed that it is looking actively to make investments, while also prepared to bide its time for opportunities when the market subsides. The current focus is both single London properties and UK portfolios. Office conversions on the Waterloo model (previously Hercules House Government offices) are also being examined.

Given management's successful development record, this is particularly exciting. Indeed, the investment case of Waterloo alone is persuasive. An independent valuation of £250m revealed a doubling of value in just four years. Otherwise we could point to similar appreciation of PPHE's 52% investment in Arena, valued at €161m at end August against a total cost of €79m.

We are also enthusiastic about potential returns from investment by Arena in both Croatia and central Europe.

Exhibit 5: Financial summary

	£000s	2015	2016	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		218,700	272,500	326,000	350,000
EBITDA		80,100	94,100	106,000	113,000
Operating Profit (before amort and except)		63,100	70,900	74,500	81,000
Intangible Amortisation		(2,000)	(2,500)	(2,500)	(2,500)
Operating Profit		61,100	68,400	72,000	78,500
Net Interest		(29,300)	(34,900)	(40,900)	(41,000)
Associates		(2,000)	(1,800)	(100)	0
Exceptionals		(1,800)	6,500	0	0
Profit Before Tax (norm)		31,800	34,200	33,500	40,000
Profit Before Tax (FRS 3)		28,000	38,200	31,000	37,500
Tax		1,200	(100)	(1,500)	(2,000)
Profit After Tax (norm)		33,000	34,100	32,000	38,000
Profit After Tax (FRS 3)		29,200	38,100	29,500	35,500
Average Number of Shares Outstanding (m)		41.8	42.2	42.2	42.3
EPS - normalised (p)		76.1	73.9	65.9	78.5
EPS - normalised fully diluted (p)		76.1	73.9	65.9	78.5
EPS - (IFRS) (p)		69.9	83.2	60.4	72.6
Dividend per share (p)		20.0	21.0	22.0	23.0
EBITDA Margin (%)		36.6	34.5	32.5	32.3
Operating Margin (before GW and except.) (%)		28.9	26.0	22.9	23.1
BALANCE SHEET					
Fixed Assets		885,600	1,122,300	1,201,000	1,171,000
Intangible Assets		21,900	25,200	24,000	23,000
Tangible Assets		687,500	947,200	1,020,000	990,000
Income units sold to private investors		125,500	122,500	120,000	118,000
Investments		50,700	27,400	37,000	40,000
Current Assets		71,700	195,600	236,000	250,000
Restricted deposits		3,200	25,500	25,000	25,000
Stocks		1,000	2,400	3,000	3,200
Debtors		9,100	12,600	13,000	13,800
Cash		50,600	144,700	183,000	184,000
Other		7,800	10,400	12,000	24,000
Current Liabilities		(59,900)	(173,000)	(175,700)	(76,700)
Creditors		(48,500)	(54,700)	(55,700)	(56,700)
Deposits from unit holders		0	0	0	0
Short term borrowings		(11,400)	(118,300)	(120,000)	(20,000)
Long Term Liabilities		(629,500)	(814,700)	(835,000)	(887,000)
Long term borrowings		(440,100)	(642,100)	(662,000)	(731,000)
Financial liability to unit holders		(136,200)	(134,000)	(132,000)	(128,000)
Other long term liabilities		(53,200)	(38,600)	(41,000)	(28,000)
Net Assets		267,900	330,200	426,300	457,300
CASH FLOW					
Operating Cash Flow		83,200	79,500	106,000	113,000
Net Interest		(32,500)	(37,300)	(39,800)	(39,500)
Tax		(100)	0	(1,000)	(2,000)
Capex		(63,100)	(87,300)	(45,000)	(30,000)
Acquisitions/disposals		(3,600)	(64,300)	(65,000)	0
Exchange rate		6,000	(26,700)	(15,000)	0
Dividends		(8,300)	(50,600)	(9,300)	(9,500)
Other		(5,800)	(500)	80,000	0
Net Cash Flow		(24,200)	(187,200)	10,900	32,000
Opening net debt/(cash)		373,500	397,700	584,900	574,000
HP finance leases initiated		0	0	0	0
Other		0	0	0	0
Closing net debt/(cash)		397,700	584,900	574,000	542,000

Source: PPHE accounts, Edison Investment Research

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