

Hongkong & Shanghai Hotels (45.HK)

Premium Hospitality & Leisure Services Provider

Hong Kong | Hotel | Company report

5 January 2017

Worldwide Top Tier Hotel Brand

Hongkong & Shanghai Hotels primarily operates in hospitality and leisure services segments and about 73% of its revenue in 1H2016 comes from the hotel segment. The company is most well-known for its famous hotel chain, Peninsula Hotel. Peninsula Hotels are located in the large major cities in North America, Europe and Asia and the footprints of Peninsula Hotels can be found not just in Hong Kong, but also in Tokyo, Paris, New York and Chicago. In total, Peninsula Hotels have over 3,000 available rooms with about 2,200 available hotel rooms in the Asian continent, contributing to about 70% of the total available hotel rooms of the whole group and about 70% of the total revenue of the hotel segment across years. In particular, the Hong Kong segment of Peninsula Hotel has been the company's main revenue engine, with about 24% of the revenue generated by Hong Kong Peninsula Hotel in 1H2016. The company's hotel operation business does not only include the hotel room leasing business, but also include food and beverage, the shopping arcade and the associate office building leasing business. In particular, these arms of the hotel business contribute to about 46% of the hotel operation segment revenue in 1H2016.

Revenue Composition of the Company across Years



Source: Company Reports, Phillip Securities

Apart from the company's hotel operation business, the company also engages in the investment property business, with residential, retail and commercial properties available for leasing. The investment property business generates about 17.5% of the total revenue in 1H2016. In particular, the residential arm of the investment property generates a majority of its revenue, most of which are generated by the residential property in Repulse Bay, Hong Kong and with a GFA of almost 1,000,000 square feet. The company has an ownership percentage of 100%.

Accumulate

CMP: HKD 8.46

(Closing price as at 3 Jan 2017)

TARGET: HKD 9.70 (+14.7%)

COMPANY DATA

O/S SHARES (MN) :	1,567
MARKET CAP (HKDMN) :	13,256
52 - WK HI/LO (HKD):	9.49 / 7.15

SHARE HOLDING PATTERN , %

Bermuda Trust Company Limited	38.29
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PRICE PERFORMANCE , %

	1M	3M	1Y
HK & SH Hotels	(5.47)	9.44	0.71
HSI	(1.90)	(6.40)	(0.78)

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY14	FY15	FY16E	FY17E
Net Sales	5,838	5,741	5,576	5,753
Net Profit	1,131	1,005	755	819
EPS, HKD	0.7600	0.6500	0.4826	0.5233
PER, x	11.50	13.23	18.39	17.47
BVPS, HKD	23.6658	23.6079	23.9697	24.3621
P/BV, x	0.37	0.36	0.37	0.38
ROE, %	3.2	2.8	5.4	5.7

Source: Company reports, Phillip Securities Est.

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Expansion to European Continent

According to the diagram below, Peninsula Hotel has strong presence mainly in the developed cities in Asian and American continents. However, the company has a lack of presence in the developed European region and has only one hotel in Paris. The company has been actively expanding to the European continent. In December 2015, the company announced that the London Westminster Council has approved the company's proposal to build the new hotel, 'The Peninsula London', at Grosvenor Place. Further in 26/7/2016, the company has acquired the full attributable interest of 'The Peninsula London'. 'The Peninsula London' will provide 190 hotel rooms and up to 28 residential apartments, each come with their own leisure and spa facilities. Besides the company will also build 23 intermediate affordable home nearby. The hotel and the apartments will be completed in 2021.

Hongkong & Shanghai Hotels' Geographical Presence



Source: Company Reports, Phillip Securities

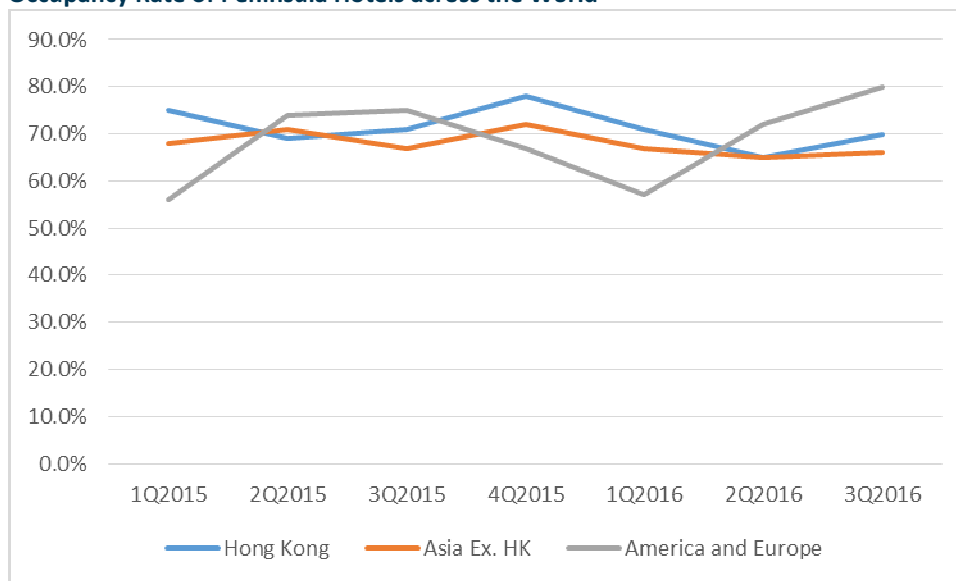
The company has also been preparing to break into the Middle East region by setting up a joint venture with other company to invest EUR150Mn for the development of 'The Peninsula Istanbul'. Besides, the company has acquired 70% majority interest for the hotel development project, 'The Peninsula Yangon' in Myanmar. The project consists of the development of a hotel complex as well as a residence complex, 'The Peninsula Residences Yangon'. The master lease of the site for 'The Peninsula Yangon' has been signed on 23/7/2016.

We believe these projects will not only allow the company to break into the European region and the Southern Asian region, but also allows the company to generate sizable revenue, given London being the heart of Europe and the district near the hotel site being the traditional luxurious residential area. Moreover, Istanbul is also one of the most popular destination for travel in Middle East and we expect the hotel to become one of the important milestone for the company's expansion.

Hotel Segment Performance

Hotel occupancy rate in general has improved in 3Q2016 in comparison with 2Q2016, with the Peninsula Hotels in American and European continents continuing its 3-quarter consecutive growth in occupancy rate from 57% in 1Q2016 to 80% in 3Q2016. The hotel occupancy rate in Asian region has dropped slightly due to the renovation work being carried out in the Beijing hotel. The occupancy rate in Hong Kong has improved from 65% in the 2Q2016 to 70% in 3Q2016. We expect the occupancy rate to further improve for the reason that the fourth quarter is a traditional holiday season and fourth quarter result consistency outperformed the result in third quarter in the past for most of the regions.

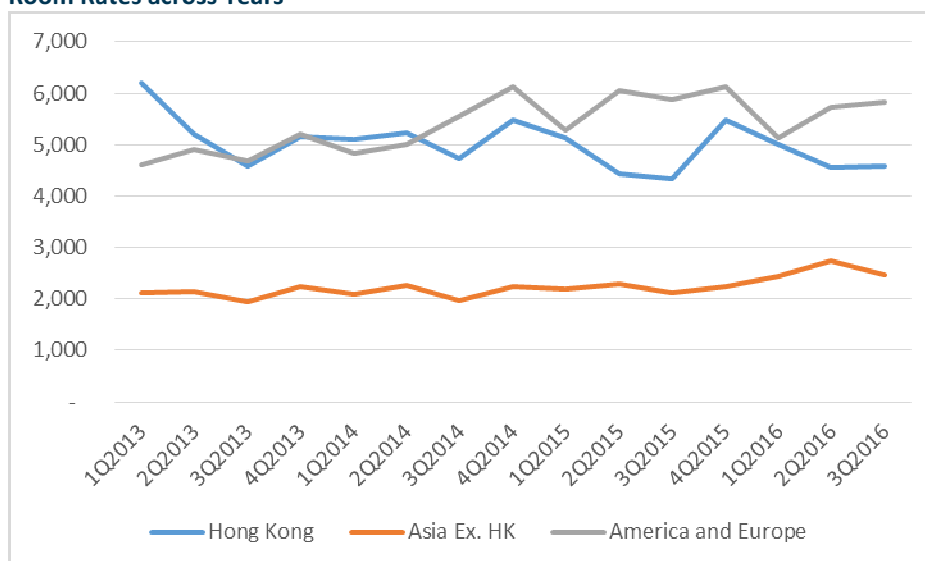
Occupancy Rate of Peninsula Hotels across the World



Source: Company Reports, Phillip Securities

The following is the average room rates in each quarter the company charges.

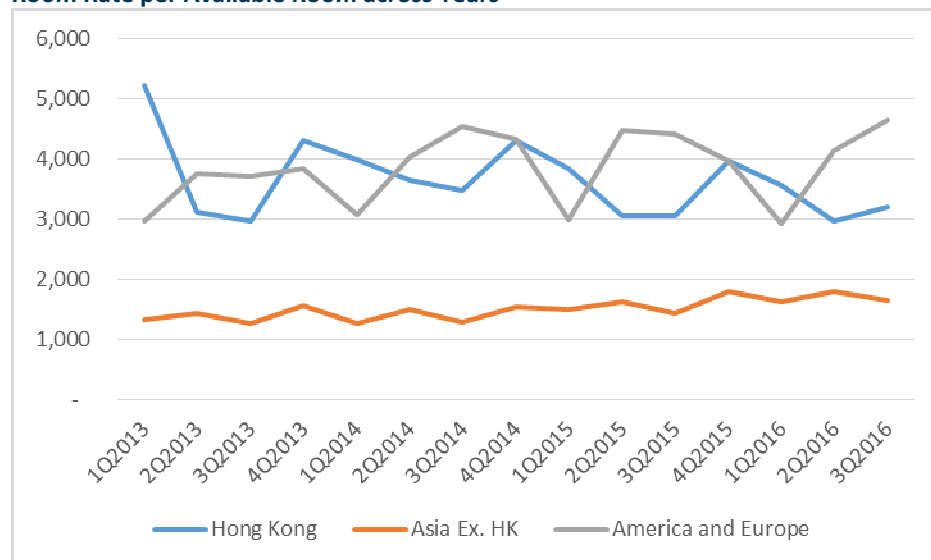
Room Rates across Years



Source: Company Reports, Phillip Securities

Apart from hotel in Hong Kong, which has shown a deteriorating trend in room rate ever since 2013, Hotels in other continents has a general rising trend, as evident by the average room rates for hotels in Asia has risen from the 3-quarter average of HKD2,064 in 2013 to the 3-quarter average of HKD2,552 in 2016. For the hotels in America and Europe, the 3-quarter average room rate has risen from HKD4,732 in 2013 to HKD5,572 in 2016. However, the one for Hong Kong has dropped from HKD5,333 in 2013 to HKD4,718 in 2016.

Room Rate per Available Room across Years



Source: Company Reports, Phillip Securities

We expect the room rates per available room to improve in the fourth quarter of 2016 and rise above that of the third quarter of 2016. Traditionally, the room rate in the fourth quarter is much higher than the room rate in the third quarter in all regions while occupancy rate is higher in the fourth quarter than in the third quarter in all regions except America & Europe.

Room Rate (in HKD)	Q3 Average	Q4 Average
Hong Kong	4,561	5,370
Asia Ex. Hong Kong	2,122	2,236
America & Europe	5,490	5,825

Source: Company Reports, Phillip Securities

Occupancy Rate	Q3 Average	Q4 Average
Hong Kong	70.0%	80.3%
Asia Ex. Hong Kong	66.0%	69.7%
America & Europe	79.0%	70.7%

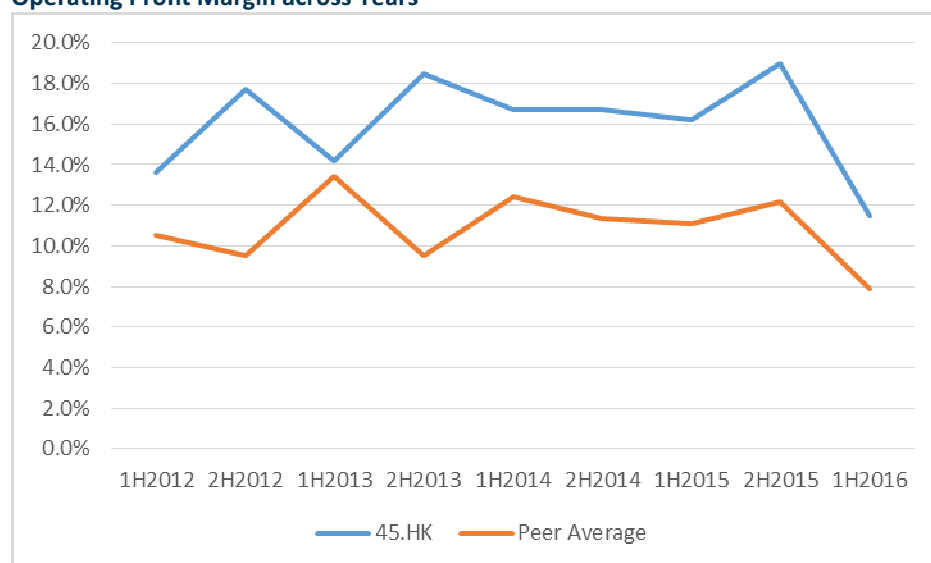
Source: Company Reports, Phillip Securities

Despite the fact that the room rate being traditionally higher in the fourth quarter, we expect the Hong Kong region performance not to reach 2013 high in both occupancy rate and room rate perspective because of Renminbi, the currency which the majority of the Hong Kong overnight visitors use, has depreciated by a large amount ever since it reached its high in 2014. This will affect the purchasing power these tourists have in Hong Kong, thereby affecting the demand for top tier hotels.

Financial Analysis

Comparing the company with its peers operating in the luxurious hotel segment, the company consistently achieves a higher operating profit margin than its peers do. However, the margin has contracted during 1H2016 because the Beijing and Chicago Peninsula Hotels were both under renovation but ordinary operating expenses such as personnel and utility expenses were incurred as usual, leading to a lower profit during the period. Such downturn is considered to be temporary and will recover in the future.

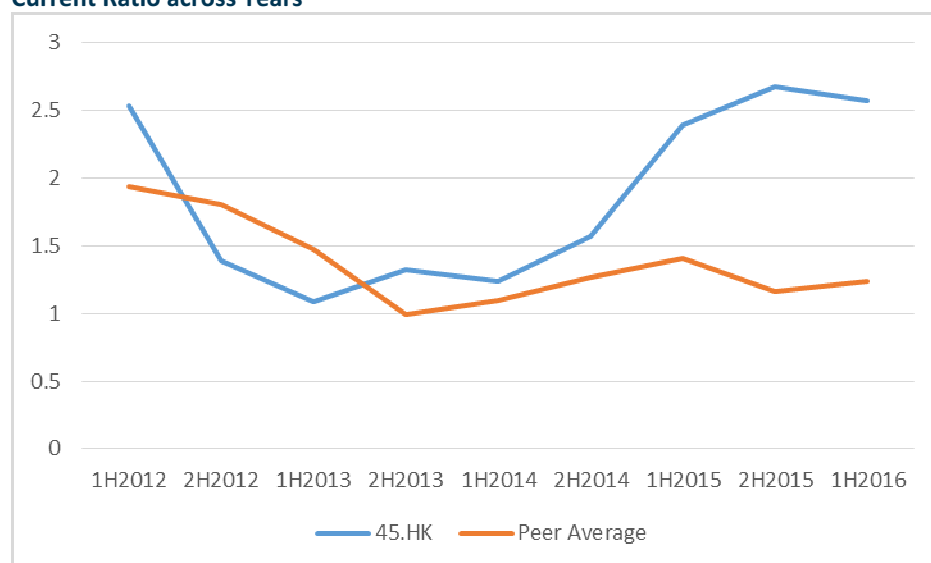
Operating Profit Margin across Years



Source: Thomson Reuters

The company also has very strong liquidity, with its current ratio way above its peers. In particular, the entire cash balance in 1H2016 can be used to pay off all the current portion of the outstanding payable and the current ratio is more than two times of its peers in both 2H2015 and 1H2016.

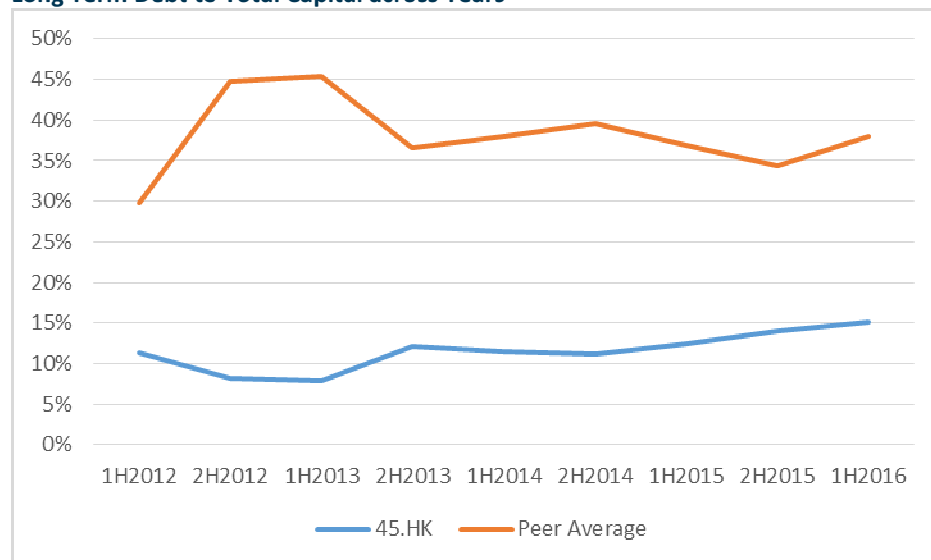
Current Ratio across Years



Source: Thomson Reuters

Besides, the company has very low leverage in comparison with the sector, allowing the company to face challenges in the tourism sector in a more prepared manner as well as employing capital into new development project quickly especially with its huge cash balance.

Long Term Debt to Total Capital across Years

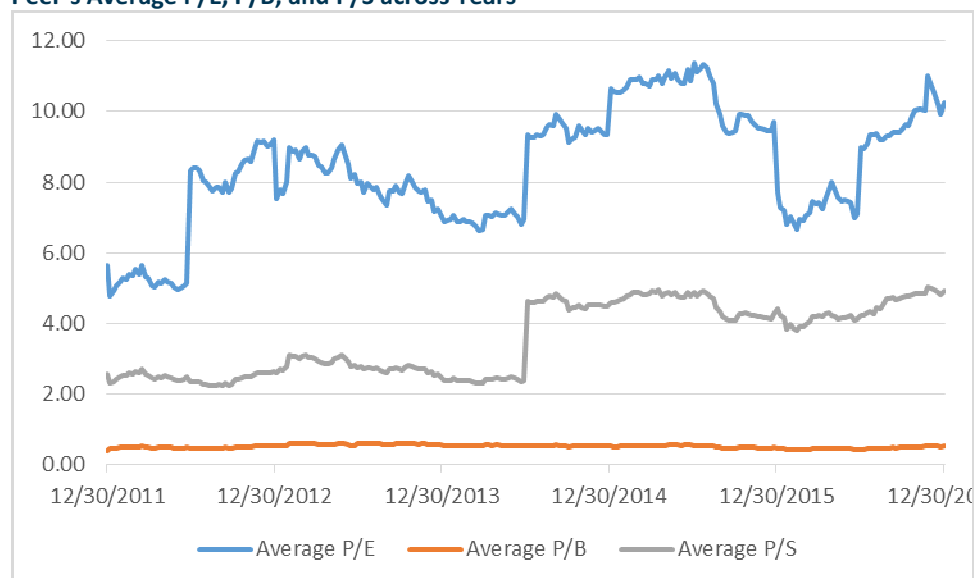


Source: Thomson Reuters

Valuation

The peer average P/E, P/B and P/S are 8.41x, 0.52x and 3.55x respectively. The company's target price is therefore \$9.70, with Accumulate rating assigned. (Closing price as at 3 Jan 2017)

Peer's Average P/E, P/B, and P/S across Years



Source: Bloomberg, Phillip Securities (HK) Research

Risk

- Increased exposure in Europe and Middle East, which have high risk of terrorist attack
- Delay in opening of new hotels
- Rapid depreciation of Renminbi

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings (P/E)	9.65	11.50	13.23	18.39	17.47
Price to Book (P/B)	0.47	0.37	0.36	0.37	0.38
Per Share Data (HKD)					
EPS	1.1400	0.7600	0.6500	0.4826	0.5233
Book Value Per Share	23.3722	23.6658	23.6079	23.9697	24.3621
Dividend Per Share	0.1600	0.2300	0.2000	0.1208	0.1310
Growth & Margins (%)					
Growth					
Revenue	6.4	6.0	(1.7)	(2.9)	3.2
Operating Income	11.5	21.3	(8.2)	(8.5)	8.2
Net Profit	10.0	(33.9)	(11.1)	(24.8)	8.5
Margins					
Operating Profit Margin	16.5	18.9	17.7	16.7	17.4
Net Profit Margin	31.1	19.4	17.5	13.6	14.3
Key Ratios					
ROE (%)	4.9	3.2	2.8	5.4	5.7
ROA (%)	4.0	2.6	2.2	1.6	1.8
Income Statement (HKD Mn)					
Revenue	5,508	5,838	5,741	5,576	5,753
- Operating Expenses	(4,597)	(4,733)	(4,727)	(4,648)	(4,750)
Operating Income	911	1,105	1,014	928	1,003
- Net Non-Operating Gain	1,032	257	115	(75)	(78)
Pretax Income	1,943	1,362	1,129	853	925
- Income Tax Expenses	(231)	(231)	(124)	(98)	(106)
Net Profit	1,712	1,131	1,005	755	819

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 3 Jan 2017)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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