HollAnd Advisors

Holland Views – ~~redacted~~ – Price: $90; MCap: $29.4bn; EV: $39bn

Diamond in the rough

Readers know the type of businesses we love: global **Brands**, **Tolls** on activity, **Asset-light,** with a low cost of growth and preferably with **Founder** involvement. These types of businesses can be phenomenally cash generative, but there can be even more on offer. In the right hands, they also can easily support *judicious* financial leverage which can juice per share earnings and thus offer substantial IRRs for shareholders. Many companies have some of these traits – very few have them all. We think we have found one such business and it is trading on c.13x owner earnings (14.6x adj. headline P/E).

A teaser: The investment opportunity in 10 bullets:

1. This investment might be quickly dismissed by many as its domination is in a sector that is notoriously capital intensive and very out of favour. Yet it is itself extremely asset light. It is a **#1 market leader** with 8% market share globally and 16% market share by in the US.
2. This 93-year-old company owns a portfolio of 30 of the best **global brands** in its sector.
3. Because the business, in effect, generates a volume-driven **toll** from its customers' use of its brands and proprietary know-how, **return on capital** is exceptional. Indeed so good, it is hard to quantify. For example: 1) 2019 net income of c.$2.2bn on basically zero tangible equity or 2) $2.8bn operating income on zero Net Tangible Assets [$1.9bn PP&E and -$2bn in working capital].
4. It has a good track record of **growth** (>>5%) but has a cost of organic growth which is very low. By our estimates, investing only 10-15% of annual owner earnings can fuel c.6% volume growth (leaving lots leftover for shareholders!).
5. This company clearly understands optimum **Capital Structure** and thus uses debt carefully. As of April 2020, it has net debt to EBITDA of 2.7x and liquidity for 30 months.
6. **What you win**: We think this business trades on c.13x pre-Covid Owner Earnings (OE). Using our OE calculation in 2019 [EBITDA – tax – interest – maintenance capex]. Our compounding model suggests an **IRR** of >18%pa without any re-rating.
7. In March 2020 its credit card partners forward paid $900m to the company; a serious vote of confidence in the business and a hint of the cash generation of its reward scheme. **Negative working capital** from Rewards is another subtle layer to this onion.
8. The head of the **family**, whose surname is the main brand (always a good incentive to do right!) is soon handing over the Chair to his son. We think the company communicates to investors with great clarity which not only makes our job easier but in our experience, often means that the company likely operates with clarity too.
9. The company's average unit **pricing** tracks its market leadership. That is, it has the highest average revenue/unit in the industry reflecting mix and brand power.
10. **Caveats**? Covid. The reason such a seemingly great business is so cheap is because it operates in the hospitality industry and thus its capacity utilisation and profits have been decimated since Covid struck in March. Our job is to highlight the best businesses that will survive, thrive and compound capital at exceptional rates. This is one such company.

The company is **Marriott International** (MAR)

This brief note expands on the 10 points listed on page 1 from a high level perspective. Some sections below are intentionally brief as although important are self-explanatory. Other sections such as that on Returns are meatier. The key is the combination of each of these attributes.

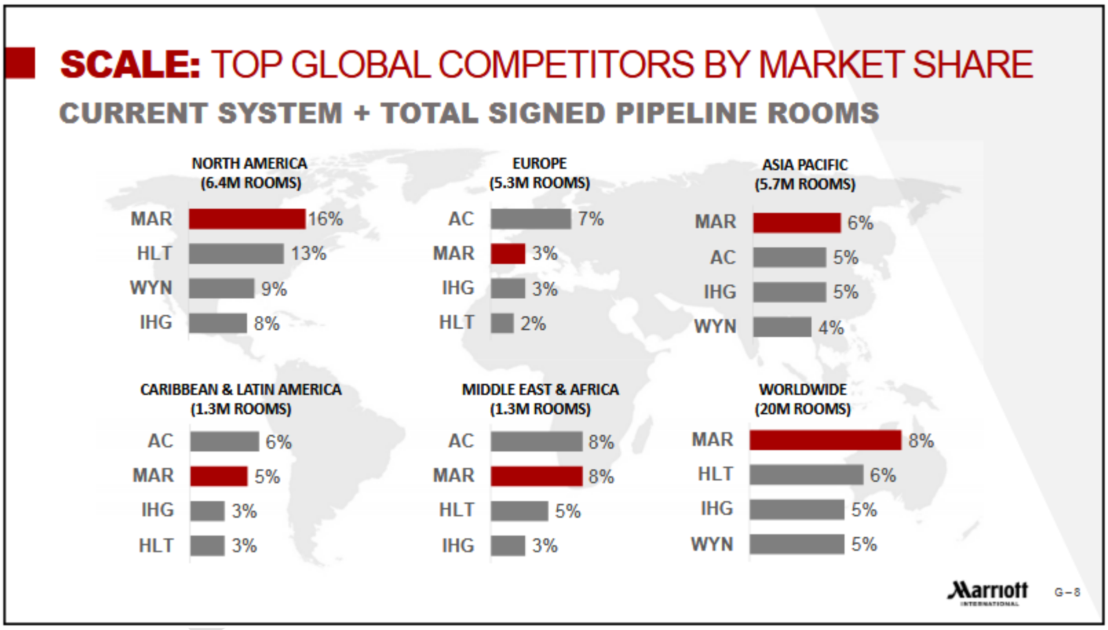
Please note much of the supporting material is gleaned from Marriott's 2019 capital markets day and annual report (please see Appendix for links). We deliberately wanted to appraise this business without the shadow of Covid. This is a business with an excellent track record, there is no question in our mind that it is a survivor and a thriver.

That said, this was not an obvious share to like at first glance and we probably would not have recognised the attractiveness of the business without having learn from our earlier work on American Tower and Ashtead. Marriott is a great company priced like an average one.

1. Market Leadership

Fig.1 shows the dominance that MAR enjoys globally. Of the 1.3m rooms that are rented under one of Marriott's brands, about 2/3 are located in the US and the remaining 1/3 split equally between Asia and EMEA. As the company itself categorises its portfolio, 9% are deemed "luxury", 47% "upper scale" and 44% "upscale and upper midscale".

Fig.1: Market Share by region



Source: Marriott International

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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