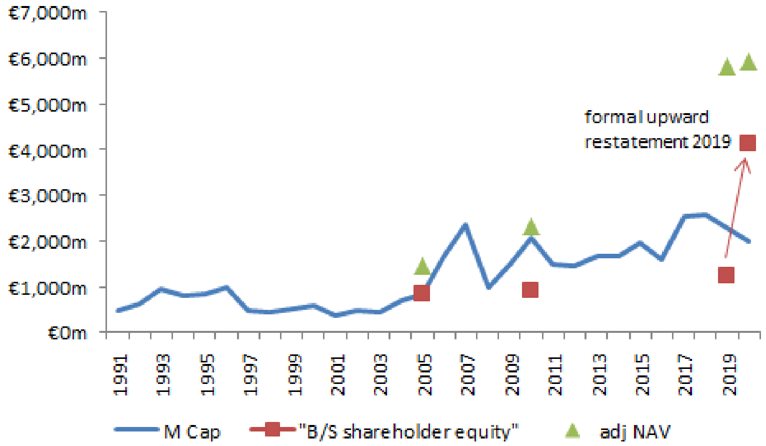
HollAnd Advisors

Holland Views – Mandarin Oriental Price: $1.57; MCap: $1.9bn; EV:$2.3bn

The rarest of things

Mandarin Oriental (MO) is that rarest of things; a renowned luxury brand, but one with significant asset backing to boot. A quick look at the widening disconnect between the share price and asset value of MO will show you why we looked a little harder at it this spring. The magnitude of upside still on offer to equity investors is enormous. Simply put this is a company with $5.9bn of a recently revalued net assets that has a market cap of just $2bn aka a price/book of 0.33x. To paraphrase Mandarin Oriental's regular FT advert: "we are fans".

Fig 1: A massive Margin of Safety



Source: Holland Advisors

We just can't write fast enough

We first looked at MO during our Jardine Strategic work last summer (*Holland Views – Jardine Strategic – Are you a value investor really? Nov 2019*). In that note, we highlighted the sizable undervaluation of MO against its revalued property estate. In property/asset backed companies this is not unheard of. However, MO enjoys a lack of something important that almost all low price to NAV property companies have in abundance: Debt! When MO shares then fell off a cliff this spring, we looked a little harder alongside our studies of Marriot and Whitbread (the latter we have yet to write on but are happy to share our views). With the Keswick family owning 77% of the shares in MO via their Jardine holding company that does not leave a lot of share liquidity for everyone else. Indeed, that lack of liquidity could well be one of the reasons as to why the shares have been volatile (along with HK political disruption), but hey that is Mr Market working in our favour. We did this work a few weeks back but just cannot write up our ideas fast enough these days. We are also aware that more than a few clients will find this share too illiquid and thus we will keep our comments brief:

The main points

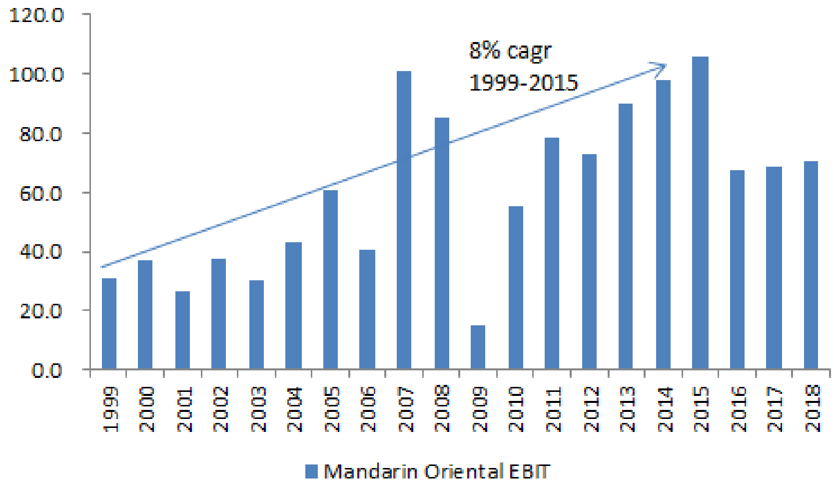
- M Cap US$1.98bn + Net Debt 300m = EV of US$2.3bn
- Enjoys a pre-eminent exclusive/niche brand with serious asset underpinnings
- Had only 7 hotels in 2003, but now earns income from 33 hotels
- It owns or has equity stake in 15 of those hotels. These 15 generated the majority of profits in 2019

- Quite a few of those 33 hotels have been or are in various states of refurbishment so earnings are under-stated in recent years as suggested in Fig.2 below
- Since 2014, the company had embarked on a significant expansion and refurbishment program – aka an investment cycle which is coming to a completion
- New Pipeline for 20 hotels – notably all managed, i.e. with little equity interest, so less capital consuming than past expansion
- The company has a stated intention to open three new MO branded hotels every year
- The decision in 2017 to monetise the value of the massive HK Excelsior site possibly marks a new shift in management's thinking towards a more asset-light model

Asset value/Earning power

- MO has an accounting book value of US$4.1bn (which was partially marked to market last year, when it was revised upwards by an additional c.$3bn)
- It also has a **market adjusted book value is US$5.9bn** as per Fig.1 (vs. a market capitalisation of $2bn).
- Several key hotels have not been contributing to group profits of late due to refurbishments e.g. 2019 adj EBITDA was $155m (vs. c.$188m in 2018)
  - Last year's decline was due to the closure of the famous Excelsior hotel in HK in 2019 (more on this later)
- So underlying EBITDA margin is 188/1398 = say 13% margin vs. over 65% EBITDA margin for Marriot group. We note that Marriott's 'owned hotels' EBIT margin is >18%. It looks to us that MO has been under-earnings since 2016.

Fig,2: Under-earning since 2016?



Source: Mandarin Oriental

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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