F·P·A FINANCIAL
Investment Perspectives
24 June 2021

HOTEL RESEARCH

Mandarin Oriental Intl Ltd

SGX: M04
Bloomberg: MAND:SP
ISIN Code: BMG578481068

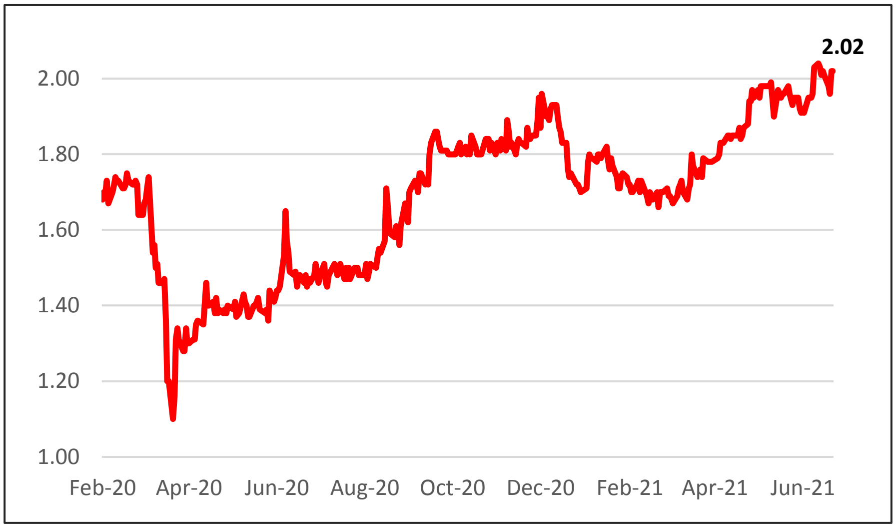
RECOMMENDATION: BUY

Current Price: US$2.02
Current Target Price: US$2.90

Issued shares: 1,263.2 million
Market capitalisation: US$2,551.7 million

52-week range: US$1.40 - US$2.06

Price Performance



Company description

Mandarin Oriental International Limited (Mandarin Oriental) is the publicly-listed parent company of Mandarin Oriental Hotel Group (the Group), an international hotel investment and management group with Asian roots. The Group currently operates 34 hotels and 7 residences in 24 countries and territories.

Summary

For the year ended 31 December 2020 (FY2020), the Group's financial performance was severely impacted owing to the impact of the Covid-19 pandemic. Revenue declined by 68% year-on-year (y-o-y) to US$183.7 million amid an unprecedented decline in global travel and temporary closure of hotels. The Group implemented cost containment measures such as reducing spending on non-essential costs and lowering payrolls. However, a loss attributable to shareholders of US$680.1 million was recorded for the period, translating to a loss per share of 53.84 cents. Excluding the impact of non-trading items, the Group's underlying business performance was still negatively impacted. Underlying loss to shareholders was US$205.9 million, translating to an underlying loss per share of 16.30 cents. Meanwhile, no dividends were declared in respect of FY2020 while the recommendation of a final dividend of 1.50 cents in respect of FY2019 had been withdrawn on 9 April 2020.

Recommendation

Since our initiation report issued on 22 June 2020, when Mandarin Oriental's share price traded at US$1.46, the share price has rallied by nearly 40% to the current price of US$2.02. Currently, we believe a potential privatization offer for Mandarin Oriental could be supporting the share price rally. Given Jardine Matheson's current ownership of 79% in Mandarin Oriental, we estimate a potential privatization offer price of US$2.90 per share, factoring in a privatization premium of 43.6%. The offer price represents a 29.0% discount to Mandarin Oriental's adjusted NAV per share of US$4.09. Meanwhile, our peer comparison analysis suggest that the share price could reach US$3.15 if Mandarin Oriental were to trade at the peer average P/NAV of 0.77x. We believe this share price could be achieved in the long term given further normalization of international travel. In the near to medium term, we believe that upside potential could be largely supported by a potential privatization offer. Considering the above, we will maintain a buy recommendation on Mandarin Oriental and our current target price is US$2.90

Key Financials

Full year, ended Dec 31	Revenue (US$ million)	Shareholders' profit (US$ million)	EPS (cents)	P/E (x)	DPS (cents)	Dividend yield (%)	NAV per share* (US$)	P/NAV (x)
2019 actual	566.5	(55.5)	(4.39)	n/m	-	-	4.70	0.43
2020 actual	183.7	(680.1)	(53.84)	n/m	-	-	4.09	0.49
2021 forecast	235.2	(93.0)	(7.36)	n/m	-	-	-	-
2022 forecast	284.6	(72.7)	(5.76)	n/m	-	-	-	-

P/E, P/NAV and dividend yield figures are based on current price of US$2.02. n/m: not meaningful

**Based on adusted shareholders' funds which accounts for revaluation of the Group's freehold & leasehold land and buildings*

Source: Mandarin Oriental, FPA Financial

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FINANCIAL REVIEW FOR FY2020

(I) Financial performance

In FY2020, the Group's financial performance was severely impacted as the Covid-19 pandemic led to an unprecedented decline in global travel and the temporary closure of hotels. While government support and improved demand in Q3 and Q4 2020 owing to the gradual lifting of restrictions had helped to mitigate the negative impact during Q2, the Group's revenue still decreased by 67.6% year-on-year (y-o-y) to US$183.7 million in FY2020. Cost of sales amounted to US$233.0 million compared to US$364.7 million a year ago, mainly due to fixed costs such as property taxes, insurance and utilities, while payroll and variable costs were significantly reduced. Accordingly, the Group recorded a gross loss of US$49.3 million compared to a gross profit of US$201.8 million a year ago.

Non-essential costs including sales & marketing expenses, global advertising, and administrative expenses such as travel and consultancy fees were significantly reduced. Compared to a year ago, selling & distribution costs declined by 19.1% to US$31.4 million, while administration expenses dropped by 16.8% to US$97.5 million. Other operating expenses fell by 8.0% y-o-y to US$6.9 million. Meanwhile, the Group recorded US$474.9 million in fair value loss on investment property under development in relation to its Causeway Bay site in Hong Kong, compared with a US$67.3 million loss a year ago. Consequently, operating losses amounted to US$660.0 million, compared to a loss of US$29.0 million a year ago.

During the period, net financing charges fell by 14.3% y-o-y to US$12.6 million, comprising US$14.2 million in financing charges and US$1.6 million in interest income. The decrease came despite higher debt, given a substantial reduction in base interest rates. Meanwhile, losses from associates & joint ventures increased to US$26.8 million from US$1.7 million. This was largely due to losses at the Group's hotel in New York, as significant property-related costs continued to be incurred despite the hotel's closure.

Given the above, the Group incurred a pre-tax loss of US$699.4 million compared to a loss of US$45.4 million in FY2019. During the period, the Group recorded a tax credit of US$19.4 million, primarily reflecting a deferred tax write-back of US$14 million relating to the impairment of the Group's hotel in Geneva. Accounting for the tax credit, the Group recorded an after-tax loss of US$680.0 million for the period, of which US$680.1 million was attributable to shareholders after factoring in US$0.1 million in non-controlling interests.

Given US$680.1 million in losses attributable to shareholders, the Group incurred a loss per share of 53.84 cents during the period, which compared to a loss per share of 4.39 cents in FY2019. Meanwhile, no dividends were declared in respect of FY2020 while the recommendation of a final dividend of 1.50 cents in respect of FY2019 had been withdrawn on 9 April 2020 owing to the severe impact of the Covid-19 pandemic.

The Group's financial results for FY2020 and FY2019 are summarized in **Exhibit 1** on the next page.

Exhibit 1: Group's financial results for FY2020 and FY2019

[US$ million]	FY2020	FY2019	y-o-y change
Revenue	183.7	566.5	-67.6%
Cost of sales	(233.0)	(364.7)	-36.1%
Gross (loss)/profit	(49.3)	201.8	n/m
Selling & distribution costs	(31.4)	(38.8)	-19.1%
Adminsitration expenses	(97.5)	(117.2)	-16.8%
Other operating (expense)/income	(6.9)	(7.5)	-8.0%
Change in fair value of investment property under development	(474.9)	(67.3)	>100%
Operating (loss)/profit	(660.0)	(29.0)	>100%
Net financing charges	(12.6)	(14.7)	-14.3%
Share of results of associates and joint ventures	(26.8)	(1.7)	>100%
(Loss)/profit before tax	(699.4)	(45.4)	>100%
Tax	19.4	(10.2)	n/m
(Loss)/profit after tax	(680.0)	(55.6)	>100%
(Loss)/Profit attributable to:			
Shareholders	(680.1)	(55.5)	>100%
Non-controlling interests	0.1	(0.1)	n/m
	(680.0)	(55.6)	>100%
(Loss)/Profit attributable to equity holders	(680.1)	(55.5)	>100%
Weighted average no. of shares in issue (million)	1,263.2	1,263.2	-
EPS (cents)	(53.84)	(4.39)	>100%

Source: Mandarin Oriental, FPA Financial

As the Group uses 'underlying profit' to distinguish between ongoing business performance and non-trading items, we would also review how its underlying business has performed. For this, we would have to consider the Group's non-trading items, which are separately identified to provide greater understanding of the Group's underlying business performance.

Items classified as non-trading items include fair value gains/losses on revaluation of investment property under development and investments as well as gains and losses arising from the sale of businesses, investments and properties, among others. During FY2020, the Group recorded a fair value decrease of US$475.2 million in property under development, which was recorded under non-trading items. This was in relation to a 15% valuation decrease for its Causeway Bay site under development (previously the site of The Excelsior hotel in Hong Kong) to approximately US$2.5 billion (net of future construction costs) at the end of 2020. Including a US$0.7 million increase in the fair value of other investments, net non-trading losses amounted to US$474.2 million. This compared to losses of US$96.7 million recognized during FY2019, which were primarily in relation to the Causeway Bay site under development.

Excluding the impact of non-trading items, which amounted to net losses of US$474.2 million, the Group's after-tax loss would amount to US$205.8 million during FY2020, of which loss attributable to shareholders was US$205.9 million after accounting for US$0.1 million in non-controlling interest. Consequently, the Group's underlying loss per share amounted to 16.30 cents in FY2020, compared to an underlying earnings per share of 3.26 cents in FY2019.

Exhibit 2 below summarises the Group's financial results for its underlying business, non-trading items and total business.

Exhibit 2: Group's financial results for underlying business, non-trading items and total business

	FY2020			FY2019		
[US$ million]	Underlying performance	Non-trading items	Total	Underlying performance	Non-trading items	Total
Revenue	183.7	-	183.7	566.5	-	566.5
Cost of sales	(233.0)	-	(233.0)	(364.7)	-	(364.7)
Gross (loss)/profit	(49.3)	-	(49.3)	201.8	-	201.8
Selling & distribution costs	(31.4)	-	(31.4)	(38.8)	-	(38.8)
Adminsitration expenses	(97.5)	-	(97.5)	(117.2)	-	(117.2)
Other operating (expense)/income	(7.6)	0.7	(6.9)	25.2	(32.7)	(7.5)
Change in fair value of investment property under development	-	(474.9)	(474.9)	-	(67.3)	(67.3)
Operating (loss)/profit	(185.8)	(474.2)	(660.0)	71.0	(100.0)	(29.0)
Net financing charges	(12.6)	-	(12.6)	(14.7)	-	(14.7)
Share of results of associates and joint ventures	(26.8)	-	(26.8)	(1.7)	-	(1.7)
(Loss)/profit before tax	(225.2)	(474.2)	(699.4)	54.6	(100.0)	(45.4)
Tax	19.4	-	19.4	(13.5)	3.3	(10.2)
(Loss)/profit after tax	(205.8)	(474.2)	(680.0)	41.1	(96.7)	(55.6)
(Loss)/Profit attributable to:						
Shareholders	(205.9)	(474.2)	(680.1)	41.2	(96.7)	(55.5)
Non-controlling interests	0.1	-	0.1	(0.1)	-	(0.1)
	(205.8)	(474.2)	(680.0)	41.1	(96.7)	(55.6)
(Loss)/Profit attributable to equity holders	(205.9)	-	(680.1)	41.2	-	(55.5)
Weighted average no. of shares in issue (million)	1,263.2	-	1,263.2	1,263.2	-	1,263.2
EPS (cents)	(16.30)	-	(53.84)	3.26	-	(4.39)

Source: Mandarin Oriental

(II) Capital management

As at 31 December 2020, the Group had total assets of US$4,574.1 million compared to US$5,108.7 million a year ago. The decrease in total assets was mainly due to a decrease in investment property under development to US$2,528.3 million in relation to the Group's Causeway Bay site, as discussed on page 4.

Meanwhile, total liabilities increased to US$1,060.9 million as at 31 December 2020 from US$992.1 million a year ago. The increase was mainly attributed to a rise in borrowings of US$99.7 million, which brought the Group's total debt to US$670.8 million as at 31 December 2020. Net of bank and cash balances of US$164.6 million, net debt stood at US$506.2 million. Accordingly, the Group's gearing, as measured by net debt over shareholders' funds, stood at 14% as at 31 December 2021 compared to 7% a year ago, as shown in **Exhibit 3**. At 14% gearing, we believe this could suggest that the Group's leverage is still manageable.

Consequently, the Group's recorded net assets of US$3.513.2 million as at 31 December 2020, which comprised US$3,509.5 million in shareholders' funds and US$3.7 million in non-controlling interests. Based on shareholders' funds of US$3,509.5 million, the Group's net asset value (NAV) per share was US$2.78 as at 31 December 2020, as shown in **Exhibit 3**.

Exhibit 3: Summary of the Group's balance sheet as at 31 Dec 20 and 31 Dec 19

[US$ million]	31-Dec-20	31-Dec-19
Total assets	4,574.1	5,108.7
Total liabilities	1,060.9	992.1
Net assets	3,513.2	4,116.6
Shareholders' funds	3,509.5	4,113.0
No. of issued shares	1,263.2	1,263.2
NAV per share (S$)	2.78	3.26
Total debt	670.8	571.1
Net debt	506.2	300.4
Gearing (1)	14%	7%

(1) Based on net debt over shareholders' funds

Source: Mandarin Oriental

The above-mentioned NAV per share of US$2.78 does not take into account any appreciation in the value of the Group's owned hotel properties, given the adoption of the historical cost convention. Nonetheless, the Group also conducts a review of the fair market value of its hotels in conjunction with independent appraisers on an annual basis.

Including a US$1,661 million increase in the fair market value of the Group's freehold & leasehold land and buildings, the Group reported adjusted shareholders' funds of US$5,170.9 million as at 31 December 2020. Accordingly, the Group's adjusted NAV per share stood at US$4.09 as at 31 December 2020, as shown in **Exhibit 4** on the next page. This adjusted NAV per share would be a better indicator of the current value of the Group's net assets, which would otherwise be understated as any potential appreciation of the Group's hotels would not have been accounted for.

Exhibit 4: Group's adjusted NAV per share for FY2020 and FY2019

	FY2020		FY2019	
	US$ million	Per share (US$)	US$ million	Per share (US$)
Shareholders' funds	3,510	2.78	4,113	3.26
Add: surplus for fair market value of freehold & leasehold land and buildings	1,661	1.31	1,823	1.44
Adjusted shareholders' funds	5,171	4.09	5,936	4.70

Source: Mandarin Oriental

Based on adjusted shareholders' funds of US$5,170.9 million, the Group's gearing ratio stood at 9.8% as at 31 December 2020 compared to 5.1% a year ago, as shown in **Exhibit 5**.

Exhibit 5: Group's gearing based on adjusted shareholders' funds

[US$ million]	31-Dec-19	31-Dec-20	31-Mar-21
Adjusted shareholders' funds	5,936.1	5,170.9	5,360.0
Net debt	300.4	506.2	536.0
Gearing	5.1%	9.8%	10.0%

Source: Mandarin Oriental, FPA Financial

In its interim management statement issued on 5 May 2021, the Group updated that net debt stood at US$536 million as at 31 March 2021 and cash reserves amounted to US$150 million. Gearing was 10% of adjusted shareholders' funds, as shown in **Exhibit 5** above.

OPERATIONAL UPDATES

In FY2020, the Group's operations were severely impacted owing to the Covid-19 pandemic as many hotels were closed for several months. In Asia, most hotels were able to remain operational, albeit with sharply reduced occupancy due to constraints on travel. There was, however, a recovery in the second half for the Group's managed hotels in the Chinese mainland. In Europe and America, hotels closed for much of Q2 2020, with most reopening thereafter.

Portfolio revenue per available room (RevPAR) declined by 63% to US$105 in FY2020 from US$280 in FY2019. In terms of geographical segment, RevPAR fell by 67% y-o-y to US$63 for Asia; by 49% y-o-y to US$290 for Europe, Middle East & Africa (EMEA); and by 55% y-o-y to US$142 for America, as shown in **Exhibit 6**.

Exhibit 6: Portfolio RevPAR performance in FY2020 and FY2019 – US dollar terms

Geographical segment	FY2020 US$	FY2019 US$	y-o-y change
Asia	63	192	-67%
EMEA	290	569	-49%
America	142	314	-55%
Total	105	280	-63%

Source: Mandarin Oriental

During the period, the Group completed renovations in Boston, Bangkok and Munich. Renovations at the Group's Hong Kong hotel to create new facilities were also completed in early 2021. Restoration work at Mandarin Oriental Ritz, Madrid continued, and the hotel reopened on 15 April 2021. The Causeway Bay site under development remains on track to complete in 2025.

Meanwhile, the Group's development pipeline remains strong, with many projects at an advanced stage. The Group took over the management of the Emirates Palace in Abu Dhabi at the beginning of 2020 and the Al Faisaliah Hotel in Riyadh in March 2021. New management contracts were signed and announced in 2020 in respect of Zurich and Vienna. In 2021, a new resort was announced in Da Nang, Vietnam. The recently restored Mandarin Oriental Bosphorus, Istanbul is expected to open in the first half of 2021. Currently, the Group operates 34 hotels and 7 residences.

INDUSTRY OVERVIEW

In this section, we discuss industry reviews of the hotel markets in Asia Pacific, EMEA and the US.

(I) Asia Pacific hotel market review

In its latest Q2 21 Hotel Insights report, Colliers International (Colliers) highlighted that hotels across Asia Pacific witnessed a rebound in performance at the end of Q1 2021, given the gradual easing of COVID-19 containment measures. Overall room occupancy increased to by 42.7% but average daily rate (ADR) decreased to US$78.04. Consequently, RevPAR for the region declined by approximately 17.6% y-o-y, but with positive improvement from Q4 2020.

Looking ahead, Colliers expects a continued improvement in the global economic outlook improve, with a cautious return to travel underpinned by a rebound in domestic demand. As the vaccination rollout gathers pace and more green lanes open, Colliers expects a rapid recovery led by pent-up leisure demand, followed by business demand.

(II) EMEA hotel market review

According to CBRE, hotel performance declined across all European countries in 2020. Domestic leisure demand was the key driver of hotel performance across Europe during the region's partial reopening throughout the year. CBRE highlighted that provincial markets generally outperformed gateway and capital cities which typically rely more on international and business-related demand.

On the outlook, CBRE expects hotel revenues to broadly recover to pre-pandemic levels by 2024, assuming that an effective vaccine is widely administered by mid to late 2021 and accounting for the socio-economic consequences of the virus. CBRE believes the initial phase of recovery will be driven by domestic demand. Countries with typically strong domestic leisure demand and less exposure to inbound travel markets, particularly long-haul, are likely to see performance bounce back sooner.

However, markets and hotels are unlikely to recover in a uniform manner and the speed of recovery will be influenced by factors such as location, business mix & segmentation, condition, technological innovation, management, market position and supply pipeline.

(III) US hotel market review

According to data from STR and Tourism Economics (TE), the US hotel market suffered a 50.1% y-o-y decline in RevPAR to US$42.88 in 2020, reflecting the severe impact of the Covid-19 pandemic. Nonetheless, STR and TE Tourism Economics recently upgraded their US hotel forecasts on the back of stronger-than expected demand in Q1 2021.

The latest forecast data suggest y-o-y RevPAR growth of 36.2% to US$58.39 in 2021, representing a 32.0% decline compared to 2019, as shown in **Exhibit 7** on the next page. Further recovery is expected in 2020, with RevPAR forecasted to increase by 20.9% to US$70.57, which would be 17.9% below the 2019 level. However, full recovery of demand remains on the same timeline for 2023, while close-to-complete recovery of revenue per available room (RevPAR) is still projected for 2024.

Exhibit 7: Key performance indicators for the US hotel market

	Actual	Forecast			
	2020	2021		2022	
Metric	US$	US$	y-o-y change	US$	y-o-y change
Occupancy (%)*	41.6%	53.3%	28.1%	60.1%	12.8%
ADR	103.00	109.47	6.3%	117.34	7.2%
RevPAR*	42.88	58.39	36.2%	70.57	20.9%

**Reflects Total-Room-Inventory (TRI) methodology, which assumes no temporary hotel closures*

Source: STR, Tourism Economics

STR highlighted that leisure continues to be the primary source of hotel demand, and leisure travel demand is gathering strength with substantial recovery in sight for many markets. However, transient business, group and international travel face continued headwinds, and a full recovery will take several years. Nonetheless, improving weekday occupancies indicate that some business travel is back in the marketplace. However, group business remains the further off from a meaningful recovery, though there is hope for upward movement in the segment as more events resume.

SHARE PRICE PERFORMANCE REVIEW

Since our initiation report issued on 22 June 2020, when Mandarin Oriental's share price closed at US$1.46, the share price has rallied by nearly 40% to the current price of US$2.02.

The increase in share price could be in part attributed to improved earnings expectations on the back of an improved travel outlook. Increased vaccination progress globally has helped to ease Covid-19 health concerns, allowing for the reopening of economies and a gradual recovery in travel, though a full recovery could still take a few years. Recent travel surveys suggest that there is pent-up demand for travel, and a rebound in leisure travel is expected to lead the recovery in global travel, while business travel remains weak.

Meanwhile, we believe another factor driving up the share price could be a potential takeover of Mandarin Oriental by its parent organisation, the Jardine Matherson Group. Recently, Jardine Strategic Holdings (Jardine Strategic) was privatised by Jardine Matheson Holdings (Jardine Matheson), which has fuelled market speculations over the possibility for Mandarin Oriental to be taken private. Since the announcement of a privatisation offer for Jardine Strategic on 8 March 2021, Mandarin Oriental's share price has gained by about 20%. In our view, the privatisation factor could be a major catalyst in supporting upside in the share price. We will discuss this further in the Valuation section on page 19.

FINANCIAL PROJECTIONS

(I) Revenue projection

The Group's revenue can be classified into the geographical segments of Asia, EMEA and America. Historically, Asia has the largest contribution to overall revenue. During FY2020, revenue from the Asia segment was US$96.9 million, making up 52.7% of total revenue. The EMEA and America segments generated revenue of US$66.1 million and US$20.7 million respectively, with respective proportioning of total revenue at 36.0% and 11.3%. The geographical breakdown of the Group's revenue in FY2019 and FY2020 is summarised in **Exhibit 8**.

Exhibit 8: Revenue breakdown in terms of geographical segments for FY2019 and FY2020

	Revenue			
	FY2019		FY2020	
Geographical segment	US$ million	% of total	US$ million	% of total
Asia	272.2	48.0%	96.9	52.7%
EMEA	189.5	33.5%	66.1	36.0%
America	104.8	18.5%	20.7	11.3%
Total	566.5	100.0%	183.7	100.0%

Source: Mandarin Oriental

In our projections, we will adopt potential RevPAR growth in the Group's individual geographical segments as a proxy for projected revenue growth for each segment. Below, we provide our views on how the outlook for hotel performance in the US, Europe and Asia.

Owing to vaccination progress and supportive fiscal and monetary policies in many economies, the global growth outlook has improved. Global distribution of vaccines has helped to stabilise the Covid-19 situation worldwide significantly compared to last year. With the easing of health concerns, the international travel outlook has improved as countries relax border controls and people regain confidence in travelling. Moreover, recent surveys suggest that there is strong pent-up demand for travel. As highlighted in the Industry Overview section, a recovery in global travel has been led mainly by a rebound in leisure travel demand. However, business and group travel demand remains relatively subdued, and full recovery will likely take a few years.

In the US, a strong growth backdrop and improved virus situation have fuelled optimism for a strong recovery in hotel performance. Strong domestic leisure demand is expected to lead the recovery as business and group travel remains relatively subdued. Recently, the US has also taken initial steps to relax travel bans on countries like the UK and those in the European Union (EU). As highlighted on page 9, latest forecasts by STR and TE suggest annual RevPAR growth of 36.2% in 2021, followed by a further y-o-y growth of 20.9% in 2022.

In Europe, accelerated vaccination progress has helped to stabilize the virus situation, which has allowed countries such as Germany and France to ease lockdown measures which were reintroduced in early 2021. Against an improving virus backdrop in Europe, the EU recently lifted travel restrictions for inbound US visitors, while the US has also relaxed travel bans on the UK and EU countries. There have also been encouraging news from airline companies like Air France and Deutsche Lufthansa regarding plans to increase flight capacity.

Meanwhile, a strong growth outlook is also observed for Asia, as countries in the region like China, Singapore and Taiwan were amongst the first to recover from the pandemic. However, parts of Asia such as China, specifically in Guangzhou city, India, Malaysia, Singapore and Taiwan have recently been hit with new waves of infections, forcing the need for tightened measures. For instance, Guangzhou has been placed under lockdown; Malaysia recently extended its Movement Control Order (MCO) for two weeks; Singapore recently tightened measures and has had to slow the easing of measures due to new virus clusters.

Thus, it is likely that the pace of recovery in travel could vary across different regions. As it stands, the virus situation in the US appears relatively stable while Europe is catching up in the recovery on the back of accelerated vaccination progress. In contrast, parts of Asia are currently dealing with new virus waves. Another important consideration would be that the hotel market rebound in the US has been largely driven by a recovery in domestic travel. Comparatively, many markets in Europe tend to rely more heavily on tourism, and thus the recovery in international travel could play a bigger factor in the hotel recovery.

Considering the above, we are inclined to believe that the hotel recovery in Asia could potentially lag Europe and the US going forward. Comparing the US and Europe, the recovery for the latter could trail the former given greater reliance on international travel. Thus, we would assume y-o-y revenue growth of 25%, 30% and 36% (as proxied by 2021 US hotel market forecasts from STR and TE) for the Asia, EMEA and America segments respectively in FY2021.

Given expectations of further vaccination progress in 2022 across most regions, we could see a more pronounced resumption in business and group travel during the year. In view of further improvement in the travel outlook, we would expect a sustained RevPAR recovery in 2022, though the rebound could moderate from 2021 given low base effects. Further, considering that global vaccination rates should improve by 2022, the virus situation across regions should stabilise by then. Thus, we would assume an even recovery of 21% y-o-y revenue growth in FY2022 across the Asia, EMEA and America segments (as proxied by 2022 US hotel market forecasts from STR and TE).

Given the above, the projected revenue for the Asia, EMEA and America segments for FY2021 and FY2022 would be as follows:

FY2021

- Projected for Asia in FY2021= 125% x US$96.9 million = US$121.1 million
- Projected revenue for EMEA in FY2021= 130% x US$66.1 million = US$85.9 million
- Projected revenue for America in FY2021 = 136% x US$20.7 million = US$28.2 million

FY2022

- Projected for Asia in FY2022= 121% x US$121.1 million = US$146.6 million
- Projected revenue for EMEA in FY2022= 121% x US$85.9 million = US$104.0 million
- Projected revenue for America in FY2022 = 121% x US$28.2 million = US$34.1 million

Accordingly, the projected total revenue for FY2021 and FY2022 would be US$235.2 million and US$284.6 million respectively, as shown in **Exhibit 9**.

Exhibit 9: Revenue projections for FY2021 and FY2022

	Projected revenue			
	FY2021		FY2022	
Geographical segment	US$ million	% of total	US$ million	% of total
Asia	121.1	51.5%	146.6	51.5%
EMEA	85.9	36.5%	104.0	36.5%
America	28.2	12.0%	34.1	12.0%
Total	235.2	100.0%	284.6	100.0%

Source: FPA Financial

(II) EPS projections

Given our projected revenue figures for FY2021 and FY2022, we will now estimate the Group's earnings for these periods.

Gross profit

To estimate gross profit, we would consider the Group's gross margin. With reference to Exhibit 21, we note that gross margin was between 35% and 37% during FY2017 to FY2019, shown in **Exhibit 10**. Owing to the severe impact of the COVID-19 pandemic, gross margin turned negative in FY2020.

Exhibit 10: Projected gross margin for FY2021 and FY2022

	Actual				Forecast	
	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
	US$ million	US$ million	US$ million	US$ million	US$ million	US$ million
Revenue	610.8	613.7	566.5	183.7	235.2	284.6
Gross profit	221.1	225.5	201.8	-49.3	35.3	71.2
Gross margin (%)	36.2%	36.7%	35.6%	n/m	15.0%	25.0%

Source: Mandarin Oriental, FPA Financial

In our projections, we would assume a gross margin of 15.0% in FY2021 to account for an improvement in profitability amid a gradual recovery in international travel. For FY2022, we would assume gross margin to rebound to 25% in view of a further normalization in travel given the potential return of business and group travel demand. Accordingly, projected gross profit would be S$35.3 million and S$71.2 million for FY2021 and FY2022 respectively, as shown in **Exhibit 10** above.

Selling & distribution costs

In view of an improved travel outlook, largely driven by leisure demand, we could expect selling & distribution costs to increase with the gradual resumption of sales and marketing activities. To account for this, we would assume a 5% y-o-y increase in selling & distribution costs for FY2021, and a further increase of 10% in FY2022.

Administration expenses

Similar to selling & distribution costs, we would also expect some increase in administration expenses, which include items like travel and consultancy fees, as revenue improves.To account for this, we would also assume a 5% y-o-y increase in administrative expenses for FY2021, and a further increase of 10% in FY2022.

Other operating expenses/income

As noted on page 3, the Group incurred other operating expenses of US$7.6 million during FY2020 compared to an income of US$25.2 million in FY2019. For FY2021 and FY2022, we would assume neither expenses nor income to be recorded.

Change in fair value of investment property under development

During FY2020, the Group recorded US$474.9 million in fair value loss on investment property underdevelopment in relation to a valuation decline in the Causeway Bay site. For FY2021 and FY2022, we would assume no fair value gains or losses.

Net financing charges

As noted on page 3, net financing charges fell by 14% y-o-y to US$12.7 million in FY2020 despite higher debt, as base interest rates had declined. The breakdown of the Group's net financing charges for FY2019 and FY2020 are summarized in **Exhibit 11.**

Exhibit 11: Breakdown of Group's net financing charges for FY2019 and FY2020

	Actual	
[US$ million]	**FY2019**	**FY2020**
Interest expense for:		
-bank loans	(13.7)	(11.2)
-interest on lease liabilities	(2.4)	(1.9)
Commitment and other fees	(2.0)	(1.1)
Financing charges	(18.1)	(14.2)
Interest income	3.4	1.6
Net financing charges	(14.7)	(12.6)

Source: Mandarin Oriental

Given interest expenses on bank loans of US$13.7 million and total borrowings of US$670.8 million, the estimated effective interest rate on the Group's debt would be approximately 2.04% = [US$13.7 million / US$670.8 million]. Nonetheless, rising inflation expectations have resulted in a recent rise in interest rates globally.

Considering the higher rate environment, we would assume the effective interest rate to be higher at 2.20% for FY2021, and a further increase to 2.50% during FY2022. Accordingly, projected interest expense for FY2021 and FY2022 would be US$14.8 million = [2.20% x US$670.8 million] and US$16.8 million = [2.50% x US$670.8 million] respectively, assuming no debt repayment or additional borrowings during these periods. Meanwhile, we would assume the same amount for interest on lease liabilities, commitment & other fees and interest income. Thus, projected net financing charges would be US$12.3 million and US$14.3 million for FY2021 and FY2022 respectively, as shown in **Exhibit 12**.

Exhibit 12: Projected net financing charges for FY2021 and FY2022

	Forecast	
[US$ million]	**FY2021**	**FY2022**
Interest expense for:		
-bank loans	14.8	16.8
-interest on lease liabilities	(1.9)	(1.9)
Commitment and other fees	(1.1)	(1.1)
Financing charges	11.8	13.8
Interest income	1.6	1.6
Net financing charges	12.3	14.3

Source: Mandarin Oriental

Share of results from associates and joint ventures

The Group's share of results from its associates and joint ventures mainly relate to activities in hotel ownership. As noted on page 3, losses from associates and joint ventures increased to US$26.8 million during FY2020, largely due to losses at the Group's hotel in New York. Given an expected rebound in hotel markets, we could expect the Group's share of results to improve. However, given uncertainty in the recovery path for international travel, we would adopt a conservative approach to assume zero share of results from associates and joint ventures.

Pre-tax (loss)/profit

Given the above projections, we derived projected pre-tax loss of US$112.3 million and US$92.0 million for FY2021 and FY2022 respectively, as shown in **Exhibit 13**.

Exhibit 13: Projected pre-tax loss for FY2021 and FY2022

	Forecast	
[US$ million]	**FY2021**	**FY2022**
Revenue	235.2	284.6
Cost of sales	(199.9)	(213.5)
Gross (loss)/profit	35.3	71.2
Selling & distribution costs	(33.0)	(36.3)
Adminsitration expenses	(102.4)	(112.6)
Other operating (expense)/income	-	-
Change in fair value of investment property under development	-	-
Operating (loss)/profit	(100.1)	(77.7)
Net financing charges	(12.3)	(14.3)
Share of results of associates and joint ventures	-	-
(Loss)/profit before tax	(112.3)	(92.0)

Source: FPA Financial

Tax

For FY2020, the Group recorded a tax credit of US$19.4 million on the back deferment of taxes. As the Group is expected to record a pre-tax loss for FY2021 and FY2022, we would assume tax deferment as well and assume the same tax credit as in FY2020.

After-tax (loss)/profit

Adjusting for the tax credits, the projected after-tax loss for FY2021 and FY2022 would be US$92.9 million and US$72.6 million respectively. Assuming non-controlling interests of US$0.1 million in FY2020 to remain for FY2021 and FY2022, the projected loss attributable to shareholders would be US$93.0 million and US$72.7 million for FY2021 and FY2022 respectively.

Accordingly, we would derive a loss per share of 7.36 cents and 5.76 cents for FY2021 and FY2022 respectively. We have summarized our projected earnings in **Exhibit 14** on the next page.

Exhibit 14: Earnings projection for FY2021 and FY2022

	Forecast	
[US$ million]	**FY2021**	**FY2022**
Revenue	235.2	284.6
Cost of sales	(199.9)	(213.5)
Gross (loss)/profit	35.3	71.2
Selling & distribution costs	(33.0)	(36.3)
Adminsitration expenses	(102.4)	(112.6)
Other operating (expense)/income	-	-
Change in fair value of investment property under development	-	-
Operating (loss)/profit	(100.1)	(77.7)
Net financing charges	(12.3)	(14.3)
Share of results of associates and joint ventures	-	-
(Loss)/profit before tax	(112.3)	(92.0)
Tax	19.4	19.4
(Loss)/profit after tax	(92.9)	(72.6)
(Loss)/Profit attributable to:		
Shareholders	(93.0)	(72.7)
Non-controlling interests	0.1	0.1
	(92.9)	(72.6)
(Loss)/Profit attributable to equity holders	(93.0)	(72.7)
Weighted average no. of shares in issue (million)	1,263.2	1,263.2
EPS (cents)	(7.36)	(5.76)

Source: FPA Financial

(III) Dividends projection

As noted on page 3, the Group had withdrawn their recommendation of a final dividend of 1.50 cents in respect of FY2019 in April 2020 and declared no dividends in respect of FY2020, reflecting the severe impact of the Covid-19 pandemic on the Group's financials. Given projected negative earnings for FY2021 and FY2022, we would assume no dividends to be declared for both periods.

VALUATION ANALYSIS

Here, we perform an updated peer comparison analysis to account for the changes in the financial position of Mandarin Oriental and its peer companies. We will also discuss the possibility of a privatization offer for Mandarin Oriental.

(I) Peer comparison analysis

The results of our updated peer comparison analysis are summarized in **Exhibit 15** below.

Exhibit 15: Updated peer comparison

Company	SGX code	Current price (US$) as at 24 Jun 21	Market cap (US$ million)	EPS [1] (cents)	P/E (x)	DPS [2] (cents)	Dividend yield (%)	NAV per share [3] (US$)	P/NAV (x)
Mandarin Oriental Intl Ltd [4]	M04	2.020	2,551.66	(53.84)	n/m	-	-	4.09	0.49
Peers:									
CDL Hospitality Trust [5]	J85	1.260	1,545.38	(15.41)	n/m	4.95	3.93	1.32	0.95
Far East Hospitality Trust [5]	Q5T	0.595	1,170.30	(4.78)	n.m	2.41	4.05	0.79	0.75
Frasers Hospitality Trust [5] [6]	ACV	0.525	1,011.19	(6.87)	n/m	1.25	2.38	0.66	0.80
Shangri-La Asia Limited [7]	S07	7.600	27,249.80	(100.03)	n/m	-	-	13.11	0.58
Peer average	-	-	-	-	-	-	3.45	-	0.77

n/m: not meaningful

(1) Based on 12-month trailing diluted EPS

(2) Based on 12-month trailing dividends

(3) As at 31 Dec 2020, unless otherwise stated

(4) Company data in USD. Based on adjusted NAV per share.

(5) Company data in SGD

(6) NAV per share as at 31 Mar 21

(7) Company data in HKD. EPS and NAV per share are converted from USD to HKD based on USD/HKD=7.76

Source: respective company data, FPA Financial

Based on the above results in **Exhibit 15**, we note that Mandarin Oriental's P/NAV of 0.49x (based on adjusted NAV per share of US$4.09) is lower than the peer average of 0.77x. This could suggest that Mandarin Oriental is undervalued at the current price of US$2.02.

Adopting a relative valuation approach, we would estimate a target price of US$3.15 = [0.77 x US$4.09] if Mandarin Oriental were to trade at the peer average P/NAV of 0.77x. This estimated target price would represent a 55.9% upside from the current price of US$2.02.

(II) Potential privatisation offer

As noted on page 11, we believe that the recent takeover of Jardine Strategic by the Jardine Matheson has fuelled speculations over a potential privatisation offer for Mandarin Oriental. On 15 April 2021, Jardine Matheson completed the acquisition of a 15% stake in Jardine Strategic and privatized the latter, with the aim to simplify the parent structure of the Jardine Matheson Group.

The total acquisition was priced at US$5.5 billion, or US$33 per share which was at a 20.2% premium over the closing price of Jardine Strategic's shares of US$27.45 on 5 March 2021, before the proposed takeover offer was announced on 8 March. Compared to Jardine Strategic's reported NAV per share of US$58.22 as at 31 December 2020, the acquisition price was at a 43.3% discount. Following the completion of the acquisition, Jardine Matheson has become the single holding company for all its Jardine subsidiaries. As at 31 May 2021, Jardine Matheson holds an effective ownership of 79% in Mandarin Oriental; 78% in Dairy Farm International; 75% in Jardine Cycle & Carriage; and 50% in Hongkong Land, all of which are companies listed on the Singapore Exchange.

Given Jardine Matheson's substantial ownership stake in Mandarin Oriental, we foresee that there may be a good chance that the latter could be next in line for a privatization offer. There is good value in the shares of Mandarin Oriental, given that it is currently trading at more than a 50% discount to NAV.

To estimate a potential takeover offer price for Mandarin Oriental, we will consider several privatisation exercises which have taken place recently for SGX-listed companies. The details of these privatisation exercises are summarised in **Exhibit 16**.

<u>Exhibit 16: Recent privatisation offers for SGX-listed companies in 2021</u>

Target	Acquirer	Currency	Last traded share price	Latest reported NAV	Offer price (S$)	Price premium (1)	Discount to NAV (2)
Jardine Strategic Holdings Ltd (3)	Jardine Matheson Holdings Ltd	USD	27.45	58.22	33.00	20.2%	43.3%
GL Ltd (3)	Guoco Group Ltd	SGD	0.56	0.98	0.80	42.9%	18.0%
Dutech Holdings Ltd	TSI Metals HK Ltd	SGD	0.25	0.60	0.40	60.0%	33.2%
Singapore Reinsurance Corp Ltd	Fairfax Financial Holdings Ltd, Fairfax Asia Ltd	SGD	0.295	0.45	0.35	19.8%	21.4%
Average						35.7%	29.0%

(1) Refers to premium of offer price over last traded share price prior to takeover announcement

(2) Offer price discount to the company's last reported NAV per share

(3) Privatisation offer has been completed

Source: respective companies' announcements and financial statements, FPA Financial

Based on the data in **Exhibit 16** above, we note that hotel operator GL Ltd, which has similar operations to Mandarin Oriental, was privatized at the smallest discount to NAV of 18.0%. Based on this discount to NAV, Mandarin Oriental would be valued at approximately US$3.35 = [82.0% x US$4.09]. Meanwhile, Jardine Strategic's offer price was the largest discount to NAV of 43.3%. Based on this discount to NAV, Mandarin Oriental would be valued at approximately US$2.32 = [56.7% x US$4.09]. This may suggest that the potential takeover offer price for Mandarin Oriental could lie between US$2.32 and US$3.35.

To provide an objective estimation, we would adopt the average discount to NAV of 29.0% based on a larger sample size of privatization exercises as shown in **Exhibit 16**. Considering that Mandarin Oriental were to be privatized at a 29.0% discount to NAV now, the estimated takeover offer price would be US$2.90 = [71% x US$4.09]. This would represent a premium of 43.6% over the current price of US$2.02.

INVESTMENT RECOMMENDATION

Since our initiation report issued on 22 June 2020, when Mandarin Oriental's share price closed at US$1.46, the share price has rallied by nearly 40% to the current price of US$2.02. We believe that market sentiment over of a potential privatization offer for Mandarin Oriental has been a major catalyst in supporting upside in the share price.

Given Jardine Matheson's current ownership of 79% in Mandarin Oriental, we estimate a potential privatization offer price of US$2.90 per share to acquire the remaining 21% stake, factoring in a 43.6% privatization premium. The privatization offer price would represent a 29.0% discount to Mandarin Oriental's adjusted NAV per share of US$4.09.

Meanwhile, the results from our peer comparison analysis suggest that Mandarin Oriental could be undervalued, given a P/NAV of 0.49x which is lower than the peers' average of 0.77x. If Mandarin Oriental were to trade at the peer average P/NAV of 0.77x, the target price would be US$3.15, which would represent an upside of 55.9% from the current share price of US$2.02. In the near to medium term, we believe that this upside may not be achieved given that the Group's financials may continue to remain weak amid subdued international travel.

In the long term, the share price could reach US$3.15 on the back of further normalization of international travel to pre-Covid levels. In the near to medium term, we believe that a potential privatization offer for Mandarin Oriental could support upside potential in the share price. As such, our current target price would be US$2.90 based on our estimated privatization offer price.

Considering the above, our current target price would be will maintain a buy recommendation on Mandarin Oriental. However, there are still risks to our target price which we will highlight in the Risk section.

RISKS TO THE UPSIDE IN TARGET PRICE

(I) Risk of a global economic slowdown

With the acceleration of vaccination progress globally, the growth outlook for the global economy has improved as many countries gradually reopen their economies. In its latest April World Economic Outlook, the International Monetary Fund (IMF) upgraded its 2021 global growth projection to 6.0% from 5.5% previously, given additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021, and continued adaptation of economic activity to subdued mobility. However, IMF highlighted that high uncertainty surrounds this outlook, related to the path of the pandemic, the effectiveness of policy support to provide a bridge to vaccine-powered normalization, and the evolution of financial conditions.

As it stands, the virus situation in the US and Europe appears to have stabilized, but there is still a risk of virus resurgence given the ongoing discovery of new Covid-19 strains. This is currently evident in Asia, where countries such as China, India and Singapore are fighting against the new delta variant, and have had to tighten containment measures or reintroduce lockdowns. There is a risk of a global economic slowdown if there is an unexpected virus resurgence globally. This could potentially have a negative impact on the Group’s earnings given the correlation between hotel demand and economic growth.

(II) Subdued international travel due to continuation of border control measures

As noted on page 12, vaccination progress has helped to ease virus-related health concerns in the US and Europe, and thus travel restrictions between these regions have recently been gradually relaxed. However, the recovery in hotel markets has largely been driven by domestic demand as the international travel outlook remains clouded by virus uncertainty. The main concern would be a deterioration in the global virus situation which could force the need for prolonged border control measures. The negative impact on hotel markets dependent on tourism demand, such as those in Europe, will likely to be more pronounced.

Meanwhile, as noted on page 8, hotel demand has largely been supported by a rebound in the leisure travel segment, while business and group travel demand is likely to remain weak in 2021 and could take a few years for a full recovery. Work from home dynamics may also have a long-lasting impact on business travel. Being in the luxury hotel segment, which caters to affluent and business travelers, Mandarin Oriental’s business is more susceptible to weak business travel and a weak global economy.

(III) Privatisation offer price below expectation

As outlined in our Investment Recommendation, we believe that market sentiment over the potential for Mandarin Oriental has supported the rally in the share price. Given the expectation of weak Group’s financials till further normalization of international travel, we are inclined to believe that the privatization factor could be the main catalyst in share price upside in the near to medium term. This could, however, also depend on the privatization offer price, which runs the risk of falling below expectations.

(IV) No privatization offer

While there are indicators which could suggest a potential privatization offer, the outcome is still uncertain. There could be potential developments which could dismiss the possibility of a privatization offer, and thus negatively affect market sentiment. If so, a potential sell-off may not be surprising, unless there are positive earnings upside surprises.

(V) Risk of currency fluctuations

The Group's earnings are susceptible to foreign exchange risk given that transactions and investments may not be denominated in the functional currency. Recently, rising bond yields have supported US dollar (USD) attractiveness. Further, the strong growth outlook in the US could also support a strengthening of the USD. A significant strengthening of the USD could have a negative impact on the Group's earnings, given potential currency exchange losses from converting currencies like Pound, Euros or Singapore Dollar to USD.

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