HOTEL RESEARCH

Mandarin Oriental Intl Ltd

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

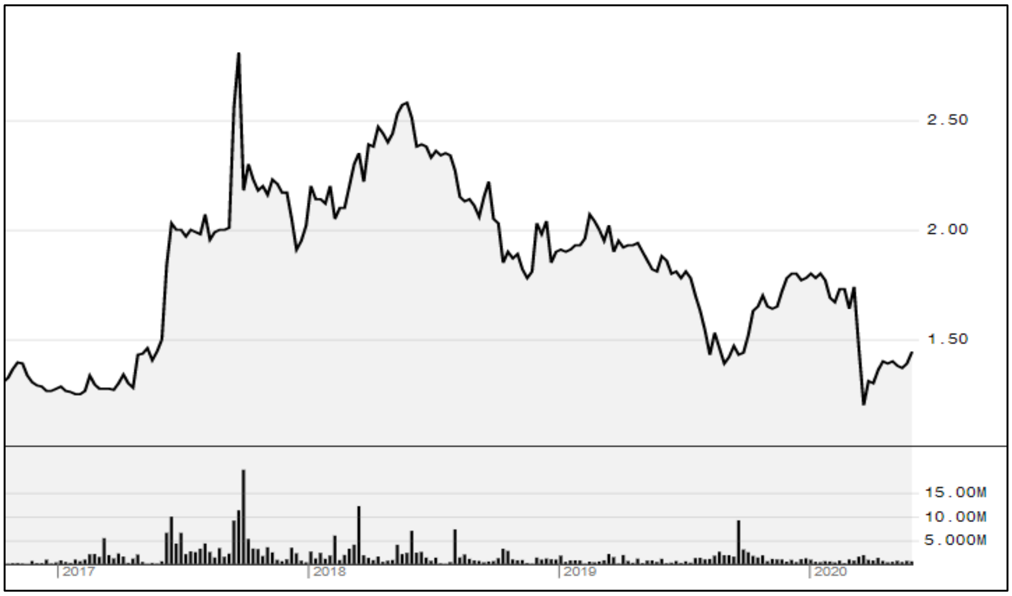
Incorporation: Bermuda
Listing: London Stock Exchange
Secondary listings: Bermuda, Singapore
Industry: Hotel

22 June 2020
RECOMMENDATION: BUY

Current price: US$1.46
Target price: US$2.18
Issued shares: 1,263.2 million
Market capitalisation: US$1,844.3 million

52-week range: US$1.06 - US$1.85

Price Performance



Source: Bloomberg

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 33 hotels and 7 residences in 23 countries and territories. As at 31 December 2019, the Group had approximately total assets of US$5.1 billion and equity attributable to shareholders of US$4.1 billion.

Summary

Mandarin Oriental's financial performance weakened in 2019 mainly due to the closure of The Excelsior hotel, the impact of the social unrest in Hong Kong and the partial closure of the Bangkok hotel for renovation. Owing to the COVID-19 pandemic, 2020 performance will be negatively impacted as hotel occupancy and RevPAR dip to unprecedented low levels. In 2021, however, hotel markets are expected to rebound and thus hotel revenue will likely improve. Further, Mandarin Oriental has a strong pipeline of development projects which are scheduled to be completed in the coming years. In addition, the redevelopment of The Excelsior site will underpin revenue in the longer term.

Recommendation

Mandarin Oriental has a low P/B of 0.45x and is trading at a 55.0% discount to book value, which indicates that the company is potentially undervalued. This is supported by our peer comparison which shows that Mandarin Oriental's P/B ratio of 0.45x is lower than the peers' average P/B of 0.67x. We adopt a relative valuation method to derive an estimated target price of US$2.18 per share if Mandarin Oriental's P/B were to re-adjust to the peers' average benchmark of 0.67x. Our target price is a conservative estimate as the NAV per share on Mandarin Oriental's accounts may be low due to the adoption of the historical cost convention. Our target implies a 49.3% upside from the current price of US$1.46 and is a 33.1% discount to book value of US$3.26 as of 31 December 2019. We issue a buy recommendation and our target price is US$2.18.

Key Financials

Year ended Dec 31	Revenue (US$ million)	Profit* (US$ million)	EPS** (US cents)	P/E (x)	DPS (US cents)	Dividend yield (%)	NAV per share (US$)	P/B (x)
2017 actual	610.8	54.9	4.37	33.41	3.00	2.05	1.01	1.45
2018 actual	613.7	64.9	5.15	28.35	3.00	2.05	0.98	1.49
2019 actual	566.5	41.2	3.26	44.79	3.00	2.05	3.26	0.45
2020 forecast	374.4	27.4	2.17	67.28	1.98	1.36	-	-
2021 forecast	534.9	40.2	3.18	45.91	2.83	1.94	-	-

Figures have been rounded
P/E, P/B and dividend yield are computed based on current price of US$1.46
** Underlying profit attributable to shareholders*
*** Based on underlying profit attributabe to shareholders*
Source: Mandarin Oriental, FPA Financial

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OVERVIEW OF BUSINESS

In this section, we will discuss Mandarin Oriental's corporate profile and the portfolio of the Group.

(I) Corporate profile

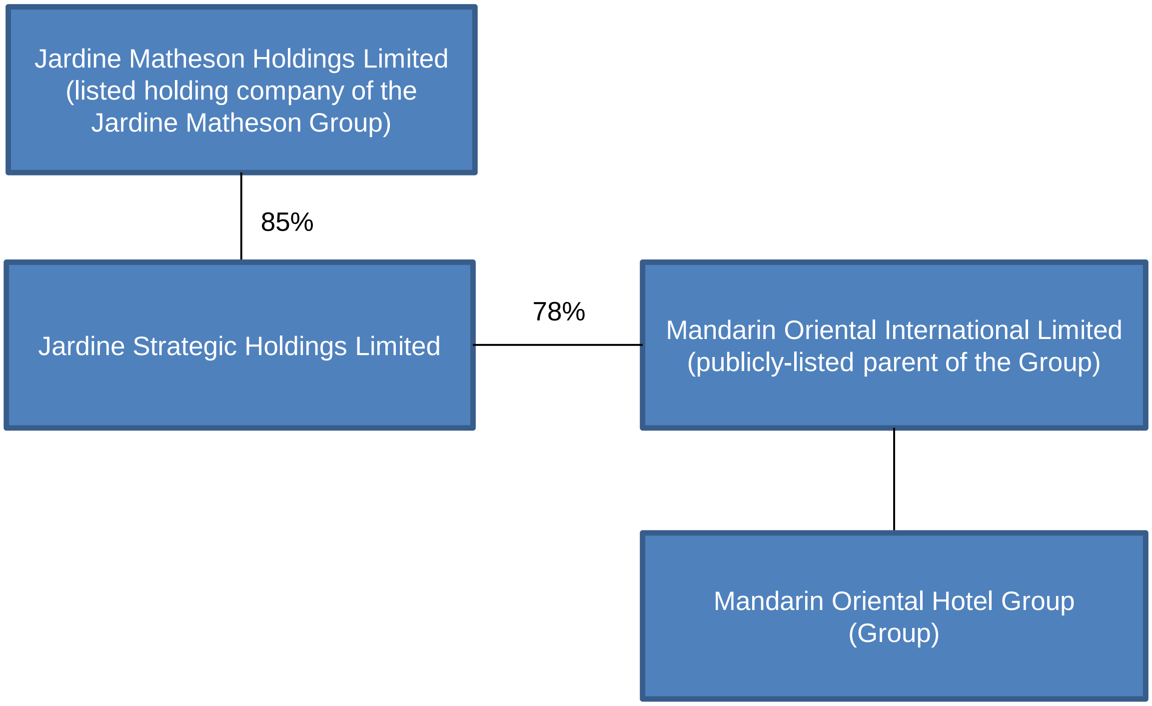
Mandarin Oriental International Limited (Mandarin Oriental or the company) is a company incorporated in Bermuda. The company's equity shares have a standard listing on the London Stock Exchange, and secondary listings in Bermuda and Singapore.

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 33 hotels and 7 residences in 23 countries and territories. As at 31 December 2019, the Group had approximately total assets of US$5.1 billion and equity attributable to shareholders of US$4.1 billion.

Mandarin Oriental is a member of the Jardine Matheson Group (Jardine Group), a diversified Asian-based group with business operations in a broad range of sectors. The Jardine Group holds its interest in Mandarin Oriental through its subsidiary, Jardine Strategic Holdings Limited, which has a 78% effective ownership in Mandarin Oriental as of 5 March 2020.

The following diagram in **Exhibit 1** illustrates an overview of Mandarin Oriental's corporate structure.

Exhibit 1: Corporate structure



Source: Compiled information from Jardine Matheson and Mandarin Oriental's annual reports

(II) Overview of the Group's portfolio

Current portfolio

The Group currently operates 33 hotels and 7 residences in 23 countries and territories spanning across Asia, Europe, the Middle East, Africa and America. The Group's current portfolio comprises a total of 7,693 hotel rooms and 611 residential units. Within its current portfolio, the Group holds ownership of 15 hotels and is responsible for the management of the other 18 hotels. **Exhibit 2** shows the list of hotels in the Group's current portfolio in Asia, Europe, Middle East and Africa (EMEA), and America, as well as the number of rooms, ownership status and Group interest for the individual hotels.

Exhibit 2: List of the Group's current hotels - hotel name, number of rooms, ownership status and Group interest

Region	Name of hotel	No. of rooms	Ownership	Group interest (%)
Asia	Mandarin Oriental, Bangkok	331	Yes	47.6
	Mandarin Oriental Wangfujing, Beijing	73	No	-
	Mandarin Oriental, Guangzhou	263	No	-
	Mandarin Oriental, Hong Kong	499	Yes	100.0
	The Landmark Mandarin Oriental, Hong Kong	111	No	-
	Mandarin Oriental, Jakarta	272	Yes	96.9
	Mandarin Oriental, Kuala Lumpur	629	Yes	25.0
	Mandarin Oriental, Macau	213	No	-
	Mandarin Oriental, Sanya	281	No	-
	Mandarin Oriental Pudong, Shanghai	362	No	-
	Mandarin Oriental, Singapore	527	Yes	50.0
	Mandarin Oriental, Taipei	294	No	-
	Mandarin Oriental, Tokyo	179	Yes	100.0
Sub-total		**4,034**	**-**	**-**
Europe, Middle East and Africa	Emirates Palace, Abu Dhabi	394	No	-
	Mandarin Oriental, Barcelona	120	No	-
	Mandarin Oriental, Bodrum	137	No	-
	Mandarin Oriental, Doha	249	No	-
	Mandarin Oriental Jumeira, Dubai	256	No	-
	Mandarin Oriental, Geneva	181	Yes	85.3
	Mandarin Oriental, Lago di Como	75	No	-
	Mandarin Oriental Hyde Park, London	181	Yes	100.0
	Mandarin Oriental Ritz, Madrid	153	Yes	50.0
	Mandarin Oriental, Marrakech	63	No	-
	Mandarin Oriental, Milan	104	No	-
	Mandarin Oriental, Munich	73	Yes	100.0
	Mandarin Oriental, Paris	135	Yes	100.0
	Mandarin Oriental, Prague	99	No	-
Sub-total		**2,220**	**-**	**-**
America	Mandarin Oriental, Boston	148	Yes	100.0
	Mandarin Oriental, Canouan	38	No	-
	Mandarin Oriental, Miami	326	Yes	25.0
	Mandarin Oriental, New York	244	Yes	25.0
	Mandarin Oriental, Santiago	310	No	-
	Mandarin Oriental, Washington D.C.	373	Yes	94.6
Sub-total		**1,439**	**-**	**-**
Grand total		**7,693**	**-**	**-**

Source: Compiled data from Mandarin Oriental

Exhibit 3 shows the residences in the current portfolio based on region and the number of units for the individual residences as of 31 December 2019.

Exhibit 3: List of the Group's current residences – name of residence and number of units

Region	Name of residence	No. of units
Asia	The Residences at Mandarin Oriental, Bangkok	146
	The Residences & Apartments at Mandarin Oriental, Macau	92
	The Residences at Mandarin Oriental, Taipei	26
Sub-total		**264**
Europe	The Residences at Mandarin Oriental, Bodrum	125
	One Hyde Park: The Residences at Mandarin Oriental, London	84
Sub-total		**209**
America	The Residences at Mandarin Oriental, Boston	74
	The Residences at Mandarin Oriental, New York	64
Sub-total		**138**
Grand total		**611**

Source: Compiled data from Mandarin Oriental

Development portfolio

Mandarin Oriental has a strong pipeline of hotels and residences under development. The Group's development portfolio comprises 18 hotels and 12 residences which are expected to open in the next 5 years. This will provide an additional 2,688 hotel rooms and 1,594 residential units. The Group will be responsible for managing the projects in the development portfolio without any equity investment. In addition, the Group had commenced the redevelopment of The Excelsior site in Hong Kong on 1 May 2019, which was formerly the location of The Excelsior hotel. More details of the Excelsior site will be discussed in the catalysts section.

Exhibit 4 shows the list of hotels in the Group's development portfolio in Asia, EMEA, and America, as well as the number of rooms for the individual hotels.

Exhibit 4: List of the Group's development hotels - hotel name and number of rooms

Region	Name of hotel	No. of rooms
Asia	Mandarin Oriental Qianmen, Beijing	72
	Mandarin Oriental, Makati	275
	Mandarin Oriental, Nanjing	106
	Mandarin Oriental, Phuket	105
	Mandarin Oriental, Saigon	228
	Mandarin Oriental, Shenzhen	178
	The Excelsior Site	-
Sub-total		**964**
Europe, Middle East and Africa	Mandarin Oriental, Dubai, Sheikh Zayed Road	259
	Mandarin Oriental Bosphorus, Istanbul	106
	Mandarin Oriental Etiler, Istanbul	158
	Mandarin Oriental Mayfair, London	50
	Mandarin Oriental Palace, Luzern	146
	Mandarin Oriental, Moscow	65
	Mandarin Oriental, Muscat	150
	Mandarin Oriental, Tel Aviv	225
Sub-total		**1,159**
America	Mandarin Oriental, Boca Raton	164
	Mandarin Oriental, Dallas	176
	Mandarin Oriental, Grand Cayman	100
	Mandarin Oriental, Honolulu	125
Sub-total		**565**
Grand total		**2,688**

Source: Compiled data from Mandarin Oriental

Exhibit 5 shows the residences in the development portfolio based on region, and the number of units for the individual residences as of 31 December 2019.

Exhibit 5: List of the Group's development residences – name of residence and number of units

Region	Name of residence	No. of units
Europe, Middle East and Africa	The Residences by Mandarin Oriental, Barcelona	34
	The Residences at Mandarin Oriental, Dubai, Sheikh Zayed Road	266
	The Residences at Mandarin Oriental Etiler, Istanbul	251
Sub-total		**1,149**
America	The Residences at Mandarin Oriental, Boca Raton	88
	The Residences at Mandarin Oriental, Dallas	100
Sub-total		**445**
Grand total		**1,594**

Source: Compiled data from Mandarin Oriental

INDUSTRY OVERVIEW

In this section, we will review industry views and projections on the hotel market in Asia, Europe and the US. We will also provide our views on how the outlook for these markets will have an impact on Mandarin Oriental.

(I) Asia hotel outlook

According to data from STR, hotel occupancy and average daily rate (ADR) in Asia Pacific declined by 60.3% yoy and 44.8% yoy in April 2020. This had contributed to a 78.1% decline in revenue per available room (RevPAR), as shown in **Exhibit 6**.

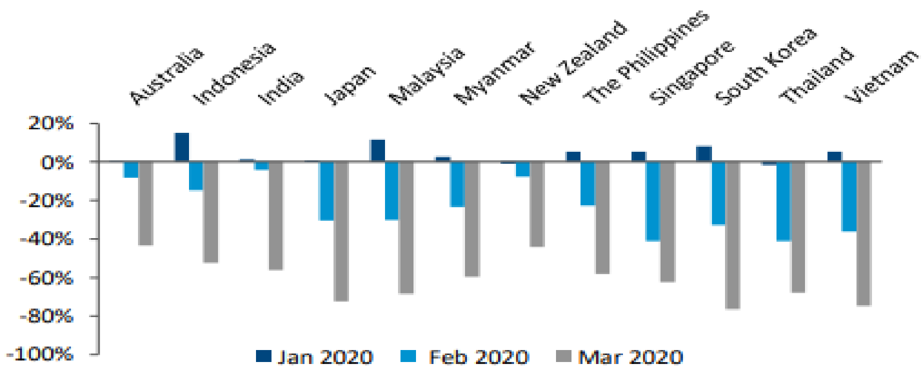
Exhibit 6: Asia Pacific hotel performance – April 2020 vs April 2019

Indicators	April 2020 vs April 2019		
	2020	2019	yoy change
Occupancy	28.0%	70.4%	-60.3%
ADR (US$)	54.97	99.61	-44.8%
RevPAR (US$)	15.38	70.14	-78.1%

Source: STR

We also note from Colliers International (Colliers) that following the confirmation of COVID-19, hotels across the Asia Pacific region began to experience a decline in hotel room occupancies. Occupancy rates fell as unprecedented travel restrictions were imposed due to an escalation of the virus situation. According to Colliers, a less extensive but similar declining trend was noted in the hotel ADR across several countries on the back of a lacklustre demand for hotel accommodation. Owing to the fall in occupancy and ADR, we note in **Exhibit 7** that hotel RevPAR across several countries in the Asia Pacific witnessed yoy RevPAR declines during the first three months of 2020. The decline in March was most severe as the COVID-19 situation worsened progressively, with all countries experiencing at least a 40% decline in RevPAR. Some countries like Japan, South Korea and Vietnam experienced a more severe RevPAR decline in March.

Exhibit 7: RevPAR % change yoy



Source: Colliers, STR

Colliers has indicated that it is expecting RevPAR in Asia to fall by 25% to 30% in 2020. Asia may be among the first to recover from the impact of COVID-19, given that Asian countries like China, South Korea and Taiwan have been amongst the first to stabilize the virus situation. We also note from STR that China's hotel market has shown signs of gradual recovery with a reopening of the economy. However, we are also mindful that there have been a second wave of infections in countries like China and South Korea, which highlights the unpredictability of COVID-19. Nonetheless, we think that Asia is likely to recover quicker and will therefore adopt a 25% decline (the lower bound of Colliers projected range) in 2020 Asia hotel RevPAR in our financial projection.

(II) Europe hotel outlook

Owing to the impact of COVID-19, we note from STR data that Europe's hotel industry recorded a 89.2% yoy decline in RevPAR in April 2020. April's RevPAR decline was contributed by a 84.6% yoy decline in occupancy and 30.1% yoy decline in ADR. The data from STR are summarized in **Exhibit 8** below.

Exhibit 8: Europe hotel performance – April 2020 vs April 2019

Indicators	April 2020 vs April 2019		
	2020	2019	yoy change
Occupancy	11.1%	71.9%	-84.6%
ADR (EUR)	85.44	122.26	-30.1%
RevPAR (EUR)	9.45	87.87	89.2%

Source: STR

For the whole of 2020, STR has forecasted RevPAR to decline by 37%. A rebound is expected in 2021, with RevPAR expected to grow by 41% from a low base. However, STR expects RevPAR recovery to 2019 levels only in 2022. We have summarized the data by STR in **Exhibit 9** below.

Exhibit 9: STR forecast for Europe hotel occupancy, ADR and RevPAR

Indicators	2021 forecast		2020 forecast		2019 actual	
		yoy change		yoy change		yoy change
Occupancy	70.1%	33.0%	52.7%	-27.0%	72.2%	0.4%
ADR (EUR)	103.34	6.0%	97.49	-14.0%	113.36	1.8%
RevPAR (EUR)	72.75	41.0%	51.60	-37.0%	81.90	2.2%

Source: STR

(III) US hotel outlook

In April 2020, US hotel occupancy and ADR fell by 63.9% yoy and 44.4% yoy respectively, according to data from STR. The dip in occupancy and ADR contributed to a 79.9% yoy decline in RevPAR for US hotels in April 2020. We have summarized the STR data for the US hotel market in **Exhibit 10** below.

Exhibit 10: US hotel performance – April 2020 vs April 2019

	April 2020 vs April 2019		
Indicators	**2020**	**2019**	**yoy change**
Occupancy	24.5%	67.9%	-63.9%
ADR (US$)	73.23	131.71	-44.4%
RevPAR (US$)	17.93	89.20	-79.9%

Source: STR

Further, we note from the latest forecast by STR, as shown in **Exhibit 11**, that occupancy and ADR for the US hotel industry in 2020 are projected to decline by 45.8% yoy and 21.6% yoy, respectively. As a result, RevPAR is expected to fall by 57.5% in 2020. In 2021, however, US hotel performance is predicted to rebound with a forecasted occupancy growth of 45.5% and ADR growth of 1.7%. This will imply a RevPAR growth of 48.0% in 2021.

Exhibit 11: STR forecast for US hotel occupancy, ADR and RevPAR

	2021 forecast		2020 forecast		2019 actual	
Indicators		**yoy change**		**yoy change**		**yoy change**
Occupancy	52.1%	45.5%	35.8%	-45.8%	66.1%	-0.1%
ADR (US$)	104.58	1.7%	102.83	-21.6%	131.11	0.9%
RevPAR (US$)	54.53	48.0%	36.84	-57.5%	86.66	0.9%

Source: STR

We also note the latest forecast from CBRE which expects a 51.9% yoy decline in RevPAR in 2020, as shown in **Exhibit 12**. This is contributed by 38.0% yoy decline in occupancy and 22.5% yoy decline in ADR. Similar to STR, CBRE predicts a US hotel market recovery in 2021, with RevPAR projected to grow by 48.4% yoy, as occupancy and ADR rebound by 36.3% and 8.9%, respectively.

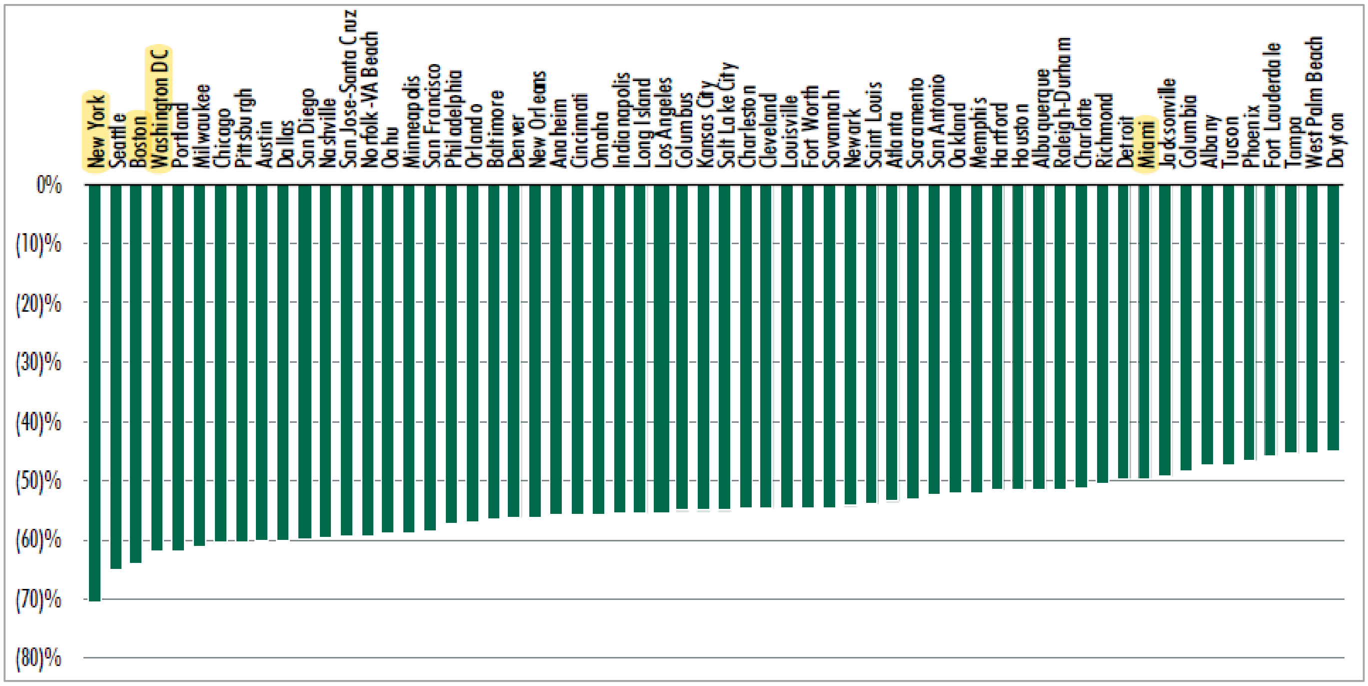
Exhibit 12: CBRE forecasts for occupancy, ADR and RevPAR

Year	Occ	ΔOcc	ADR	ΔADR	RevPAR	ΔRevPAR	ΔSupply	ΔDemand
2018	66.1%	0.4%	$129.91	2.4%	$85.90	2.9%	2.0%	2.4%
2019	66.1%	-0.1%	$131.11	0.9%	$86.64	0.9%	2.0%	2.0%
2020	41.0%	-38.0%	$101.67	-22.5%	$41.67	-51.9%	1.5%	-37.0%
2021	55.9%	36.3%	$110.69	8.9%	$61.83	48.4%	-1.1%	34.8%
2022	65.0%	16.4%	$122.93	11.1%	$79.95	29.3%	0.0%	16.4%
2023	66.6%	2.4%	$130.47	6.1%	$86.92	8.7%	0.5%	3.0%
2024	66.5%	-0.2%	$135.63	4.0%	$90.18	3.7%	0.9%	0.7%

Source: CBRE Hotels Research

We further note from CBRE that most US cities in which the Group currently owns or manages hotels are expected to suffer from more severe decline in RevPAR in 2020. The US cities of New York, Boston, Washington DC and Miami are those associated with the Group's management or ownership of hotels. We note in **Exhibit 13** that 3 out of the 4 cities are expected to experience steeper RevPAR in 2020 as compared to other US cities. CBRE's 2020 RevPAR forecasts are approximately -70% yoy for New York, -63% yoy for Boston and -62% yoy for Washington DC. Miami, on the other hand, is forecasted for a relatively less severe RevPAR decline of about 50% yoy. Given these forecasts, we would expect a much weaker revenue contribution from the Group's America segment in 2020. Nonetheless, we do note that the Group's upcoming development projects in the US are scheduled for opening beyond 2020 and could possibly avoid the impact of COVID-19 if the virus situation stabilizes by 2021 as predicted by STR and CBRE.

Exhibit 13: CBRE 2020 RevPAR forecast for US cities – yoy % change



Source: CBRE Hotels Research

FINANCIAL ANALYSIS

In this section, we will review Mandarin Oriental's fundamentals and provide our financial projections for revenue, earnings and dividends.

(I) Fundamentals performance

(a) Financial performance

In 2019, the Group's overall financial performance was weaker mainly due to the closure of The Excelsior hotel in Hong Kong on 31 March 2020, social unrest in Hong Kong and partial closure of the Bangkok hotel for renovation. In our analysis hereon, we will refer to these as 'the 3 factors'.

Group's revenue performance

The Group's revenue decreased by US$47.3 million to US$566.4 million in 2019 from US$613.7 million in 2018, as shown in **Exhibit 14** on the next page. This was in part due to weaker contributions by The Excelsior hotel given its closure on 31 March 2019. The social unrest in Hong Kong impacted the RevPAR performance of the Group's Hong Kong hotels. In 2019, the Group-owned Mandarin Oriental, Hong Kong hotel was hit by a 24% year-on-year (yoy) decline in revenue per available room (RevPAR) and the Group-managed The Landmark Mandarin Oriental hotel experienced a steeper RevPAR decline of 33% yoy. Performance was also impacted by the partial closure of the Bangkok hotel for renovations. Conversely, some of the Group's other hotels had performed better. The Tokyo hotel, for instance, was buoyed by the Rugby World Cup and experienced a 15% increase in RevPAR. However, the better results from the Group's other hotels were insufficient to compensate for the losses by the 3 factors.

The Group is operated on a worldwide basis in three regions in 2019: Asia, Europe, Middle East and Africa ('EMEA'), and America, as shown in **Exhibit 14**. In prior years, there were Hong Kong and Other Asia segments which were presented separately. However, these two segments were combined to form the Asia segment in 2019. We note in **Exhibit 14** that the Asia segment has the highest contribution to total revenue. However, the segment's performance was weaker in 2019 compared to 2018, given the impact of the 3 factors. The America segment also recorded lower contributions in 2019. Conversely, contributions by the EMEA segment was higher in 2019 due to better RevPAR performance from the EMEA hotels. The re-opening of the London hotel in April 2019 had also contributed to the segment's better performance.

In terms of business activity, we note in **Exhibit 14** that the Group's revenue is driven mainly by its Hotel Ownership segment. The segment's performance was weaker in 2019 due to weaker contributions from its owned hotels such as The Excelsior Hotel and Mandarin Oriental, Hong Kong. The performance of the Hotel & Residences branding and management segment also fared worse in 2019 compared to 2018, due in part to weaker contribution from the management of The Landmark Mandarin Oriental hotel.

Exhibit 14: Group's revenue breakdown by geographical area and business activity

	2019 US$ million	2018* US$ million	2017 US$ million	2016 US$ million	2015 US$ million
Revenue	566.5	613.7	610.8	597.4	607.3
Breakdown by geographical area					
Hong Kong	-	-	235.8	224.5	238.6
Asia	272.2	357.0	107.9	106.4	100.1
Europe, Middle East and Africa	189.5	143.7	163.8	177.8	204.9
America	104.8	113.0	103.3	88.7	63.7
Total	566.5	613.7	610.8	597.4	607.3
Breakdown by business activity					
Hotel ownership	526.9	570.3	577.6	565.4	574.0
Hotel & Residences branding and management	69.0	74.6	62.1	60.7	63.6
Less: intra-segment revenue	(29.4)	(31.2)	(28.9)	(28.7)	(30.3)
Total	566.5	613.7	610.8	597.4	607.3

**Restated figures for 2018*

Source: Mandarin Oriental

Group's earnings performance

The Group uses 'underlying profit' to distinguish between its underlying business performance and non-trading items. We will first review the Group's non-trading items using the table in **Exhibit 15**. We note that the closure of The Excelsior hotel had contributed significantly to a loss of US$95.9 million in non-trading items. This was through a total of US$28.6 million in accelerated depreciation and closure costs, and a decrease in fair value of US$67.3 million, after The Excelsior site was reclassified as an investment property under development and revalued by Jones Lang LaSalle (JLL).

Exhibit 15: Breakdown of Group's non-trading items

	2019	2018
	US$ million	US$ million
Fire at Mandarin Oriental Hyde Park, London		
Repair expenses and write-off tangible assets and other incidental expenses	(8.3)	(28.6)
Insurance recovery for replacement of tangible assets and other incidental expenses	9.0	29.6
Closure of The Excelsior, Hong Kong		
Accelerated depreciation and amortisation	(22.8)	(24.3)
Other costs	(5.8)	(2.6)
Change in fair value of investment property under development	(67.3)	-
Change in fair value of other investments	(1.5)	4.4
Total	(96.7)	(21.5)

Source: Mandarin Oriental

We note in **Exhibit 16** that taking into account the loss of US$96.7 million in non-trading items, the Group reported a loss attributable to shareholders of US$55.5 million in 2019. Excluding the contributions from non-trading items, underlying profits attributable to shareholders amounted to US$41.2 million in 2019 compared with US$64.9 million in 2018.

Exhibit 16: Group's underlying profit and profit attributable to shareholders

	Year ended Dec 31				
US$ million	2019	2018*	2017	2016	2015
Revenue	566.5	613.7	610.8	597.4	607.3
Underlying profit/(loss) attributable to shareholders	41.2	64.9	54.9	57.3	90.3
Non-trading items	(96.7)	(21.5)	-	(2.1)	(1.0)
Profit/(loss) attributable to shareholders	(55.5)	43.4	54.9	55.2	89.3

** Figures in 2018 are restated due to the adoption of IFRS 16 'Leases'*

Source: Mandarin Oriental

We will also review the Group's profitability by looking at its profitability margins. We note in **Exhibit 17** that the Group's underlying profit margin was lower in 2019 at 7% compared to 11% in 2018. This is expected as the Group's financial performance had been impacted by the closure of The Excelsior hotel, social unrest in Hong Kong and partial closure of the Bangkok hotel. The financial impact of the re-opening of several of the Group's hotels were insufficient to offset the impact of the 3 factors, resulting in weaker profitability in 2019. However, we do note that the hotel re-openings had taken place over the course of the year and thus the positive effect of the re-openings were only partially felt in 2019.

Exhibit 17: Group's profitability margins

	Year ended Dec 31				
US$ million	**2019**	**2018***	**2017**	**2016**	**2015**
Revenue	566.5	613.7	610.8	597.4	607.3
Underlying net profit/(loss)	41.1	64.7	54.5	56.5	90.4
Underlying profit margin (%)	7%	11%	9%	9%	15%
Net profit/(loss)	(55.6)	43.2	54.5	54.4	89.4
Profit margin (%)	-10%	7%	9%	9%	15%

Figures have been rounded
** Figures in 2018 are restated due to the adoption of IFRS 16 'Leases'*
Source: Mandarin Oriental

Despite the weaker financial performance in 2019, the Group was supposed to be on track for a stronger performance in 2020 due to the re-opening of its hotels. Further, the full-year impact of the hotels re-openings in 2019 would then be reflected in the 2020 financial year. However, the unprecedented COVID-19 pandemic at the start of 2020 has severely impacted the Group's financial performance. In a business update for Q1 2020, Mandarin Oriental reported an underlying loss of US$40 million. Hotel occupancy rates and RevPAR have been severely affected, and a majority of the Group's hotels were reported to be effectively closed. We note that while most of the Group's hotels in Asia have remained open, they have been hit with unprecedented low occupancy rates.

(b) Debt analysis

We note in **Exhibit 18** that the Group's total borrowings were higher at US$571.1 million in 2019 compared to US$531.5 million in 2018. This is not unexpected given the financing needs from the Group's initiatives to redevelop The Excelsior site and renovate several of its hotels such as the Bangkok and London hotels. Further, we see that the Group's debt is mainly comprised of secured borrowings that are secured to tangible fixed assets and right-of-use assets of some of the Group's subsidiaries. In 2019, the Group's secured borrowings amounted to US$549.1 million. These borrowings were secured to tangible assets and right-of-use assets with book value of US567.5 million as at 31 December 2019. The secured borrowings made up 96.8% of the book value of the assets they were secured to, which is relatively high. We think that this could be because the book value of the tangible assets and right-of-use assets are undervalued due to reporting at historical cost. This will be further developed upon in our valuation analysis.

We also note that the Group's gearing ratio, as computed by net debt over equity attributable to shareholders, has remained relatively stable from 2016 to 2018. The low gearing of 7% in 2019 was contributed by higher equity attributable to shareholders, due to the inclusion of a revaluation gain following the reclassification of The Excelsior site as an investment property under development.

Exhibit 18: Total debt and gearing ratio

	Year ended Dec 31				
US$ million	**2019**	**2018**	**2017**	**2016**	**2015**
Secured borrowings	549.1	523.2	508.2	475.6	436.0
Unsecured borrowings	22.0	8.3	2.5	4.3	4.4
Total borrowings	571.1	531.5	510.7	479.9	440.4
Less: bank and cash balances	270.7	246.8	183.9	182.6	308.6
Net debt	300.4	284.7	326.8	297.3	131.8
Equity attributable to shareholders	4,113.0	1,232.4	1,267.4	1,169.4	1,226.7
Gearing ratio (%)	7%	23%	26%	25%	11%

Source: Mandarin Oriental

We also note in **Exhibit 19** below that the Group has a higher undrawn committed debt facilities in 2019 as compared to 2018. The Group's total available borrowing facilities amounted to US$820 million as at 31 December 2019. Out of the US$820 million available, US$571 million had been drawn down, leaving US$249 million undrawn in 2019. Additionally, we see that the Group's average tenor on debt (borrowings that include bank loans) was 4.2 years in 2019 compared to 0.8 years in 2018. This will allow the Group to repay its debt over a longer period. Further, we see that the Group's cash balance is also higher in 2019 compared to 2018, reflecting greater ability for the Group to meet its debt obligations using its internal cash reserves.

Exhibit 19: Cash balance, undrawn committed debt facilities and average tenor on debt

	As at 31 Dec 19	
US$ million	**2019**	**2018**
Cash	271	247
Undrawn committed debt facilities	249	78
Average tenor on debt (years)	4.2	0.8

Source: Mandarin Oriental

(II) Financial projection

(a) Revenue projection

The methodology that we will adopt in our revenue projection would be to estimate the Group's change in revenue based on the expected RevPAR performance of its hotel portfolio. We will adopt industry projections for Asia, Europe and the US as a proxy to derive a weighted hotel RevPAR change according to the respective geographic segments room weightings. Our estimated weighted hotel RevPAR change will then be used as a proxy for the overall revenue growth to derive our revenue forecast.

Estimation of weighted RevPAR change in 2020 and 2021

We first derive the room weightings for 2020 and 2021 for the Group's existing portfolio, as shown in **Exhibit 20**. We will assume that the Group does not sell any of its existing hotels during 2020 and 2021, and thus the room weightings will remain the same for both years. (we will discuss the impact of the new hotel openings later). Further, we will adopt industry RevPAR projections for Asia (2020: -25.0%, 2021: 40.0%) and Europe (2020:-37.0%, 2021: 41.0%) on pages 8 and 9 respectively. For America, we will be adopting, as a proxy, the average of the US RevPAR projections by STR (2020: -57.5%, 2021: 48.0%) and CBRE (2020: -51.9%, 2021: 48.4%) as seen on page 10. This will imply an estimated RevPAR decline of 54.7% in 2020 and growth of 48.2% in 2021 for America, as shown in **Exhibit 20**. We will thus estimate a weighted RevPAR change of -34.0% in 2020 and 41.8% in 2021, as shown in **Exhibit 20**. The computations are as follows:

- Weighted RevPAR change in 2020 = [0.524 x -25.0%] + [0.289 x -37.0%] + [0.187 x -54.7%] = -34.0%
- Weighted RevPAR change in 2021 = [0.524 x 40.0%] + [0.289 x 41.0%] + [0.187 x 48.2%] = 41.8%

Exhibit 20: Estimation of weighted RevPAR growth

Geographic segment	Total no. of rooms		Room weighting		Projected RevPAR change		Weighted RevPAR change	
	2020	2021	2020	2021	2020	2021	2020	2021
Asia	4,034	4,034	52.4%	52.4%	-25.0%	40.0%		
Europe, Middle East and Africa	2,220	2,220	28.9%	28.9%	-37.0%	41.0%	-34.0%	41.8%
America	1,439	1,439	18.7%	18.7%	-54.7%	48.2%		
Total	7,693	7,693	100.0%	100.0%				

Source: Mandarin Oriental, STR, CBRE, FPA Financial

Revenue projection for 2020 and 2021

We will adopt our estimated weighted RevPAR change in 2020 and 2021 as a proxy for the Group's change in revenue in the respective years. Given a 34.0% revenue decline in 2020 and 41.8% revenue growth in 2021, we will estimate revenue of US$373.9 million in 2020 and US$530.2 million in 2021, as shown in **Exhibit 21**.

Exhibit 21: Revenue projection based on existing portfolio

	Year ended Dec 31		
Revenue, US$ million	2021 forecast	2020 forecast	2019 actual
Revenue	530.2	373.9	566.5
% change yoy	41.8%	-34.0%	-7.7%

Source: Mandarin Oriental, FPA Financial

As we have noted, the revenue projection above accounts for the performance of the Group's existing hotels. We would also need to consider the revenue contributions from the scheduled hotel openings in 2020 and 2021. To do so, we will estimate the revenue contributions from the new hotels by using the room rates of comparable hotels in the same locality as a proxy. We will then estimate the RevPAR for the new hotels based on the geographical industry projections for occupancy in 2020 and 2021. We have summarized our estimated RevPAR for the new hotels for 2020 and 2021 in **Exhibit 22** below.

Exhibit 22: Estimated RevPAR for new hotel openings in 2020 and 2021

				Room Rate in US$ *		Projected occupancy **		Estimated RevPAR in US$	
Geographic segment	Name of hotel/residence	Scheduled opening	Comparable hotel	2020	2021	2020	2021	2020	2021
Asia	Mandarin Oriental, Makati	2020	Makati Shangri-La, Manila	190	160	30.0%	50.0%	57	80
	Mandarin Oriental, Saigon	2020	Park Hyatt Saigon	286	269	30.0%	50.0%	86	135
EMEA	Mandarin Oriental, Dubai, Sheikh Zayed Road	2020	Mandarin Oriental Jumeirah, Dubai	395	613	52.7%	70.1%	208	430
	Mandarin Oriental Bosphorus, Istanbul	2020	Four Seasons Hotel Istanbul At The Bosphorus	473	551	52.7%	70.1%	249	386
	Mandarin Oriental Palace, Luzern	2020	Grand Hotel National Luzern	313	313	52.7%	70.1%	165	219
EMEA	Mandarin Oriental Mayfair, London	2021	Mandarin Oriental Hyde Park, London	-	924	-	70.1%	-	648
	Mandarin Oriental, Moscow	2021	Four Seasons Hotel Moscow	-	348	-	70.1%	-	244
	Mandarin Oriental, Muscat	2021	Grand Hyatt Muscat	-	221	-	70.1%	-	155
America	Mandarin Oriental, Boca Raton	2021	The Ritz-Carlton, Fort Lauderdale	-	754	-	52.1%	-	393
	Mandarin Oriental, Grand Cayman	2021	The Ritz-Carlton, Grand Cayman	-	1034	-	52.1%	-	539

**Room rates are for a 1-night stay from 30 Sep to 1 Oct 2020 in respect to 2020 and from 31 May to 1 June 2021 in respect to 2021. Room rates are based on the lowest-priced room and extracted from the respective comparable hotel websites.*

***Projected occupancy for Asia are our estimates based on industry data that have been released. Projected occupancy for EMEA and America are based on STR projections for Europe and US as a proxy*

Source: Mandarin Oriental, FPA Financial, respective hotel websites

Given our estimated RevPAR, we will estimate the revenue generated by the new hotels for 2020 and 2021. We will assume that the new hotels that are scheduled for opening in 2020 will open by September 2020, and in turn consider the revenue generated for 4 months (120 days). For 2021, we will assume opening of the new hotels from the start of the year, and in turn consider the revenue generated for a full year (365 days). This will also include the revenue from the hotels that opened in 2020. We thus estimate total revenue generated by the new hotel openings to be US$16.8 million in 2020 and US$155.8 million in 2021. The estimated revenue generated by the individual hotels are summarized in **Exhibit 23** below.

Exhibit 23: Estimated revenue by new hotel openings in 2020 and 2021

Geographic segment	Name of hotel/residence	Scheduled opening	Estimated RevPAR	No. of rooms	Operating duration (days)	Estimated revenue (US$ million)
Asia	Mandarin Oriental, Makati	2020	57	275	120	1.9
	Mandarin Oriental, Saigon	2020	86	228	120	2.3
EMEA	Mandarin Oriental, Dubai, Sheikh Zayed Road	2020	208	259	120	6.5
	Mandarin Oriental Bosphorus, Istanbul	2020	249	106	120	3.2
	Mandarin Oriental Palace, Luzern	2020	165	146	120	2.9
Total in 2020						16.8
Asia	Mandarin Oriental, Makati	2020	80	275	365	8.0
	Mandarin Oriental, Saigon	2020	135	228	365	11.2
EMEA	Mandarin Oriental, Dubai, Sheikh Zayed Road	2020	430	259	365	40.6
	Mandarin Oriental Bosphorus, Istanbul	2020	386	106	365	14.9
	Mandarin Oriental Palace, Luzern	2020	219	146	365	11.7
	Mandarin Oriental Mayfair, London	2021	648	50	365	11.8
	Mandarin Oriental, Moscow	2021	244	65	365	5.8
	Mandarin Oriental, Muscat	2021	155	150	365	8.5
America	Mandarin Oriental, Boca Raton	2021	393	164	365	23.5
	Mandarin Oriental, Grand Cayman	2021	539	100	365	19.7
Total in 2021						155.8

Source: Mandarin Oriental, FPA Financial

Nonetheless, we do note that Mandarin Oriental will only be managing the new hotels in its development pipeline, with no ownership involved. This will mean that the revenue contributions by these new hotels will be through hotel management fees, which are typically derived as a percentage of a hotel's total revenue. We note that CBRE data showed that base hotel management fees was approximately 3.3% across US hotels in 2018 [1]. We also note from JLL and Baker McKenzie, and HVS that base fees ranged from 1% to 2.9% for Asia Pacific in 2018 [2] and 2% to 4% for Europe in 2017 [3], respectively. Given the historical industry figures, we will adopt a 3% base fee rate as a proxy. We thus estimate revenue contributions by the new hotel openings in 2020 and 2021 to be US$0.5 million and US$4.7 million respectively. We therefore estimate total revenue of US$374.4 million in 2020 and US$534.9 million in 2021. This will imply a 33.9% decline and 42.9% growth in total revenue in 2020 and 2021, respectively. These are summarized in **Exhibit 24**.

Exhibit 24: Total revenue projection for 2020 and 2021

Revenue, US$ million	Year ended Dec 31	
	2021 forecast	2020 forecast
Existing hotels	530.2	373.9
New hotels	4.7	0.5
Total revenue	534.9	374.4
% change yoy	42.9%	-33.9%

Source: Mandarin Oriental, FPA Financial

Footnote: For [1] to [3], refer to References on page 39.

(b) Underlying EPS projection

In our underlying EPS projection, we will first adopt the revenue change for the existing portfolio in 2020 (-34.0%) and 2021 (41.8%) as a proxy for the changes in underlying profit attributable to shareholders in the respective years. As shown in **Exhibit 25**, we estimate underlying profit attributable to shareholders to be US$27.2 million in 2020 and US$38.6 million in 2021, based on the current operating hotels. Based on 1,263.2 million issued shares, the estimated underlying EPS for 2020 and 2021 are 2.15 US cents and 3.05 US cents, respectively.

Exhibit 25: Underlying EPS projection based on existing portfolio

	Year ended Dec 31				
	2021 forecast		2020 forecast		2019 actual
	US$ million	% change yoy	US$ million	% change yoy	US$ million
Underlying profit attributable to shareholders (existing portfolio)	38.6	41.8%	27.2	-34.0%	41.2
Issued shares (million)	1,263.2	-	1,263.2	-	1,263.2
Underlying EPS (US cents)	3.05	41.8%	2.15	-34.0%	3.26

Source: Mandarin Oriental, FPA Financial

As our estimations above are in respect to the Group's existing portfolio, we will need to further consider the earnings impact from the new hotel openings. We first note in **Exhibit 26** that the operating margin for hotel management is higher than that for hotel ownership in 2019.

Exhibit 26: Operating margin based on business activity

	Year ended Dec 31
US$ million	2019
Revenue:	
From hotel ownership	526.9
From hotel & residences branding and management	69.0
Operating profit:	
From hotel ownership	15.0
From hotel & residences branding and management	23.3
Operating margin:*	
Hotel ownership	2.8%
Hotel & residences branding and management	33.8%

**FPA computation based on operating profit divided by revenue*

Source: Mandarin Oriental, FPA Financial

Given the operating margin of 33.8% for the hotel management business in 2019, we will assume the same operating margin to estimate the operating profit contribution of the new hotels. We thus estimate the operating profit contribution to be US$0.2 million in 2020 and US$1.6 million in 2021, as shown in **Exhibit 27**. Based on the assumption that profit attributable to shareholders would be the same as operating profit, the estimated profit attributable to shareholders would be US$0.2 million in 2020 and US$1.6 million in 2021.

Exhibit 27: Estimated earnings contribution by new hotels

	Year ended Dec 31	
US$ million	2021 forecast	2020 forecast
Estimated revenue	4.7	0.5
Estimated operating profit	1.6	0.2
Operating margin	33.8%	33.8%
Estimated profit attributable to shareholders	1.6	0.2

Source: FPA Financial

Given the above, we would include the estimated earnings contribution by the new hotels to our earnings projection for the existing portfolio. Therefore, the total underlying profit attributable to shareholders is estimated to be US$27.4 million in 2020 and US$40.2 million in 2021, as shown in **Exhibit 28**. Based on 1,263.2 million issued shares, which we would assume to remain the same in 2020 and 2021, we estimate an overall underlying EPS of 2.17 US cents in 2020 and 3.18 US cents in 2021.

Exhibit 28: Overall underlying EPS projection for 2020 and 2021

	Year ended Dec 31	
	2021 forecast	2020 forecast
	US$ million	US$ million
Underlying profit attributable to shareholders (existing portfolio)	38.6	27.2
Underlying profit attributable to shareholders (new hotels)	1.6	0.2
Total underlying profit attributable to shareholders	40.2	27.4
Issued shares (million)	1,263.2	1,263.2
Total underlying EPS (US cents)	3.18	2.17

Source: Mandarin Oriental, FPA Financial

(c) DPS projection

In our DPS projection, we will also adopt the total revenue change in 2020 (-33.9%) and 2021 (42.9%) as a proxy for the changes in dividends in the respective years. As shown in **Exhibit 29**, we estimate dividends to be US$25.1 million in 2020 and US$35.8 million in 2021. This will imply an estimated DPS of 1.98 US cents in 2020 and 2.83 US cents in 2021.

Exhibit 29: DPS projection

	Year ended Dec 31				
	2021 forecast		2020 forecast		2019 actual
	US$ million	% change yoy	US$ million	% change yoy	US$ million
Final dividend in respect of 2018					18.9
Interim dividend in respect of 2019					19.0
Total dividends	35.8	42.9%	25.1	-33.9%	37.9
Issued shares (million)	1,263.2	-	1,263.2	-	1,263.2
DPS (US cents)	2.83	42.9%	1.98	-33.9%	3.00

Source: Mandarin Oriental, FPA Financial

POTENTIAL CATALYSTS

(I) Redevelopment of The Excelsior site

In October 2018, Mandarin Oriental announced its decision to close The Excelsior hotel and redevelop the site. The site is expected to be redeveloped into a commercial office building with gross floor area of 683,500 square feet. The decision to close the hotel came after the Group had reviewed the long-term strategic options for the site, which included testing market interest in a possible sale of the hotel. It was reported by South China Morning Post (SCMP) that the property was valued at approximately US$3.8 billion at that time [4]. We note from SCMP that bidders for the hotel included Sun Hung Kai Properties, Hysan Development and a joint venture by Chinese Estates Holdings and China Evergrande Group. Mandarin Oriental eventually chose to forego the hotel sale as none of the bid proposals had met fully its expectations. Following the closure of The Excelsior hotel on 31 March 2019, the Group recognized a one-time accounting revaluation gain of US$2.9 billion due to a reclassification of the asset as an investment property.

The redevelopment of The Excelsior site commenced in May 2019 and is expected to be completed in 2025. The cost of the redevelopment amounts to approximately US$650 million, which will be funded through a mix of external debt and cash reserves. The majority of the costs will not be expected to be incurred until 2023.

It has been reported by South China Morning Post (SCMP) that the office rent on The Excelsior site could potentially be the highest in the Causeway Bay, with a projected HK$100 per square feet (psf) per month [5]. Given this projection, we estimate that the commercial office building may generate an annual rental income of at least US$85 million, based on a forex rate of HK$1=US$0.13. Our estimation implies a net lettable area that is 80% of the new office building's gross floor area, which would be equivalent to 546,800 square feet. Our estimation is as follows:

- Annual rental income in US$ = 0.13 x [HK$100 psf x 546,800 square feet x 12 months] = US$85.3 million

Based on the revalued worth of The Excelsior site of US$2,967.7 million as at 31 December 2019, our estimated annual rental income of US$85.3 million will provide a yield of approximately 2.9%.

- Rental yield = [US$85.3 million / US$2,967.7 million] x100% = 2.9%

If the project completes in 2025 as expected, then Mandarin Oriental will recognize an additional revenue of approximately US$85 million per year from 2025 onwards.

Footnote: For [4] and [5], refer to References on page 39.

(II) Other pipeline projects

In 2019, the Group announced the opening of 4 hotels: Mandarin Oriental Jumeira, Dubai on 18 February 2019, Mandarin Oriental, Doha on 9 March 2019, Mandarin Oriental Wangfujing, Beijing on 15 March 2019, and Mandarin Oriental, Lago di Como on 15 April 2019.

Further, Mandarin Oriental has a strong pipeline of hotel and residential developments that will add a total of 2,688 hotel rooms and 1,594 residential units in the next 5 years. The following table in **Exhibit 30** provides the scheduled openings of the projects in the Group's development portfolio.

Exhibit 30: Scheduled openings of the Group's development projects

Geographic segment	Name of hotel/residence	Scheduled opening
Asia	Mandarin Oriental, Makati	2020
	Mandarin Oriental, Saigon	2020
EMEA	The Residences by Mandarin Oriental, Barcelona	2020
	Mandarin Oriental, Dubai, Sheikh Zayed Road	2020
	Mandarin Oriental Bosphorus, Istanbul	2020
	Mandarin Oriental Palace, Luzern	2020
EMEA	Mandarin Oriental Mayfair, London	2021
	Mandarin Oriental, Moscow	2021
	Mandarin Oriental, Muscat	2021
America	Mandarin Oriental, Boca Raton	2021
	Mandarin Oriental, Grand Cayman	2021
	Mandarin Oriental Residences at 685 Fifth Avenue, New York	2021
Asia	Mandarin Oriental Nanjing	2022
	Mandarin Oriental Phuket	2022
EMEA	Mandarin Oriental Etiler, Istanbul	2022
America	Mandarin Oriental, Dallas	2022
	Mandarin Oriental, Honolulu	2022
EMEA	Mandarin Oriental, Tel Aviv	2023
Asia	Mandarin Oriental Qianmen, Beijing	n/a *
	Mandarin Oriental, Shenzhen	n/a **

** Hotel was supposedly scheduled for opening in 2019 based on last update.*

*** Hotel was supposedly scheduled for opening in 2017 based on last update.*

Source: Mandarin Oriental

VALUATION ANALYSIS

We will present our valuation analysis in two segments. We will first provide a balance sheet analysis to review the discount at which Mandarin Oriental is trading to its book value. We will also provide a peer comparison analysis to analyse Mandarin Oriental's performance against industry peers. Based on the peer comparison, we will then adopt a relative valuation method to derive our estimated target price.

(I) Balance sheet analysis

We will review how much of a discount to book value Mandarin Oriental is trading on the market. This would provide a better understanding of whether the company is potentially undervalued.

With reference to **Exhibit 31** below, Mandarin Oriental is currently trading at a price of US$1.46 per share, implying a market capitalisation of US$1,844.3 million, based on 1,263.2 million issued ordinary shares. As at 31 December 2019, the Group reported total assets of US$5,108.7 million and total liabilities of US$992.1 million, implying a net asset value (NAV) or book value of US$4,116.6 million. NAV attributable to shareholders of US$4,113.0 million is achieved by taking out non-controlling interests of US$3.6 million from the NAV of US$4,116.6 million. Based on the NAV attributable to shareholders, Mandarin Oriental has a NAV or book value per share of US$3.26, implying a P/B ratio of 0.45x at the current share price. We thus note that company is trading at a 55.0% discount to book value. The low P/B of 0.45x may indicate that Mandarin Oriental is undervalued at the current price.

Exhibit 31: Balance sheet analysis

	US$ million
Current price (US$), as at 22 June 20	1.46
No. of issued ordinary shares (million)	1,263.2
Market capitalisation	1,844.3
Balance Sheet	**31-Dec-19**
Non-current assets	4,732.7
Current assets	376.0
Total assets	5,108.7
Less:	
Non-current liabilities	(194.6)
Current liabilities	(797.5)
Total liabilities	(992.1)
Net asset value (NAV)/Book value	4,116.6
Less: Non-controlling interests	(3.6)
NAV attributable to shareholders	4,113.0
No. of issued ordinary shares (million)	1,263.2
NAV per share (US$)	3.26
Price-to-book (x)	0.45

Source: Mandarin Oriental

Further, we note that the Group adopts a historical cost convention in the preparation of its financial statements. This means that the Group's hotel properties are stated at cost less depreciation and impairment. In this regard, we note that any potential appreciation in the value of the hotel properties would not be reflected in the balance sheet, as the Group does not record any changes in fair value for its assets. We thus see that the Group's balance sheet reflects a conservative net asset value, given the adoption of a historical cost convention. This could therefore indicate that the reported NAV on the balance sheet is understating the actual value of the Group's assets. A current revaluation of the Group's hotels would potentially reflect a much higher total asset value, and in turn net asset value. This further reinforces our view that Mandarin Oriental is potentially undervalued at the current price.

Given the above, we will further provide our estimation for a revalued NAV based on a revaluation of the Group's owned hotels. We will focus our analysis on the Group's hotels in Hong Kong, London and Paris. We will provide an estimated revalued amount of the 3 hotels value by adopting a comparative valuation approach. In other words, we will estimate the value of the 3 hotels based on the valuation of comparable assets that have been transacted recently in these 3 cities.

Revaluation of the London hotel

In determining the current valuation of Mandarin Oriental's London hotel, we note the recent sale of The Ritz London hotel at the end of March 2020, and will be using it as a comparable asset. The Ritz London hotel will be an appropriate comparison, given that it has similar characteristics as Mandarin Oriental's London hotel. The two hotels are in close proximity and are about a 5-minute drive apart from one another. The hotels are also 5-star rated and in the same category of luxury hotels. Further, we note that the room rate for a 1-night stay (from 30 Sep to 1 Oct 2020) is £586 for The Ritz London and £780 for Mandarin Oriental Hyde Park, London (comparison made on similar room types).

The Ritz London hotel was reportedly sold to a Qatari investor for £700 million [6]. We note that the previous owners purchased the hotel for £75 million in 1995. Mandarin Oriental's London hotel was acquired by the Group in 1996 for £86 million [7]. We thus note that the purchase value of both hotels were relatively close during the 1990s period.

Given the recent selling price of The Ritz London hotel at £700 million, the hotel's value per room was £5.1 million, based on a total of 136 rooms. We thus adopt the value per room for The Ritz London hotel as a proxy for Mandarin Oriental Hyde Park, London. Based on the same value per room, Mandarin Oriental's London hotel would have an estimated value of £923.1 million, as the hotel has a total of 181 rooms.

Footnote: For [6] and [7], refer to References on page 39.

Revaluation of the Paris hotel

In determining the current valuation of Mandarin Oriental's Paris hotel, we note the sale of Hotel Lutetia, Paris in 2010, and will adopt it as a comparable asset. We first note that the two hotels are close to each other, with about an 8 minute drive apart from one another. Both hotels are within the classification of 5-star luxury hotels. Further, we note that the room rate for a 1-night stay (from 30 Sep to 1 Oct 2020) is €850 for Hotel Lutetia and €1,235 for Mandarin Oriental, Paris (comparison made on similar room types).

We note that the Hotel Lutetia was reportedly sold to Israeli-based Alrov Group for approximately €150 million in 2010 [8], with the hotel ownership under its subsidiary The Set Hotels. We also note that the hotel had closed in 2014 for a €200 million renovation and reopened in July 2018 [9]. According to a 2018 valuation report by Cushman & Wakefield, Hotel Lutetia was valued at €420 million as of 30 September 2018 [10]. We further note from a 2020 valuation report by HVS that hotel values in Paris (in terms of euros) had risen by 3.3% in 2019 [11]. We will thus adopt, as a proxy, a 3.3% appreciation in the value of Hotel Lutetia to estimate a value of €433.9 million for 2019.

Given the €433.9 million value of Hotel Lutetia, we estimate the value per room to be €2.4 million, based on a total of 184 rooms after the hotel's renovation. Adopting the same value per room, we estimate the value of Mandarin Oriental, Paris to be €324.0, based on a total of 135 rooms.

Revaluation of the Hong Kong hotel

We will be using The Excelsior Hotel as a comparable asset for Mandarin Oriental, Hong Kong. As noted on page 24, The Excelsior hotel was valued at approximately US$3.8 billion in 2017. We do note that property prices are potentially higher in the Central District (where Mandarin Oriental, Hong Kong, is located) as compared to The Excelsior site in the Causeway Bay area. Meanwhile, we also note from SCMP that Hong Kong's hotel valuations had fallen by 10% in 2019 due to the anti-government protests [12]. Currently, valuations may be further impacted by the COVID-19 pandemic. Nonetheless, we will adopt, as a proxy, a 10% depreciation in the value of The Excelsior hotel to estimate a value of US$3.4 billion if it is still operating.

The value of US$3.4 billion translates to a value per room of US$3.9 million, based on a total of 869 rooms. Adopting the same value per room, we thus estimate a value of US$1,946.1 million for Mandarin Oriental, Hong Kong, based on a total of 499 rooms. We, however, note that the Excelsior hotel could have been valued based on office land use. This would imply a more optimistic valuation as we note that the value of Hong Kong offices are potentially higher than hotels.

Footnote: For [8] to [12], refer to References on page 39.

Impact of the revaluations

We have summarized the historical cost of the 3 hotels in **Exhibit 32**. The historical cost of the hotels are inclusive of renovation and upgrade costs but without netting off accumulated depreciation.

Exhibit 32: Historical cost of the London, Paris and Hong Kong hotels

			Value based on historical cost***		
Name of hotel	Group's ownership interest	Purchase date	Purchase price	Renovation/upgrade	Total
Mandarin Oriental Hyde Park, London	100%	November 1996	£86 million	£142 million	£228 million
Mandarin Oriental, Paris	100%	February 2013	€290 million	-	€290 million
Mandarin Oriental, Hong Kong	100%	September 1963*	US$14 million**	US$150 million	US$164 million

** Opening date on 1 Sep 1963. Owned by founders of Mandarin Oriental since opening.*

*** Includes construction and interior design cost amounting to HK$108 million (converted to US$ based on HK$1=US$0.13). Not inclusive of land cost.*

****Accumulated depreciation is not taken out*

Source: Mandarin Oriental, FPA Financial

Given the value of the 3 hotels based on historical cost, we estimate a valuation surplus of £695 million (US$875.7 million based on £1=US$1.26) for the London hotel, €34 million (US$38.4 million based on €1=US$1.13) for the Paris hotel and US$1,782 million for the Hong Kong hotel. In total, the valuation surplus from the 3 hotels will amount to approximately US$2,696.1 million, as shown in **Exhibit 33**.

Exhibit 33: Valuation surplus of the London, Paris and Hong Kong hotels

			Valuation surplus	
Name of hotel	Total historical cost	Revaluation		in US$ million
Mandarin Oriental Hyde Park, London	£228 million	£923 million	£695 million	875.7
Mandarin Oriental, Paris	€290 million	€324 million	€34 million	38.4
Mandarin Oriental, Hong Kong	US$164 million	US$1,946 million	US$1,782 million	1,782.0
Total				2,696.1

Source: Mandarin Oriental, FPA Financial

Balance sheet adjustments

Given the above, we will include the total valuation surplus of US$2,696.2 million to the Group's book value of US$4,116.6 million to derive an adjusted book value or NAV of US$6,812.7 million, as shown in **Exhibit 34**. This will imply an adjusted NAV attributable to shareholders of US$6,809.1 million after deducting US$3.6 million of non-controlling interests. We will thus estimate an adjusted NAV per share of US$5.39, which translates to an adjusted P/B ratio of 0.27x based on the current price of US$1.46. Therefore, if the appreciation values of the hotels are taken into account, we estimate that Mandarin Oriental's P/B will be lower than the 0.45x as noted in **Exhibit 31**.

Exhibit 34: Adjusted balance sheet

	US$ million
Net asset value (NAV)/Book value	4,116.6
Add: Valuation surplus	2,696.1
Adjusted NAV/book value	6,812.7
Less: Non-controlling interests	(3.6)
Adjusted NAV attributable to shareholders	6,809.1
No. of issued ordinary shares (million)	1,263.2
Adjusted NAV per share (US$)	5.39
Adjusted price-to-book (x)	0.27

Source: Mandarin Oriental, FPA Financial

Further, our adjustments only consider 3 of the Group's hotels, which means that the P/B will be even lower if the valuation surplus of the Group's other subsidiary hotels in Boston, Geneva, Jakarta, Munich, Tokyo and Washington D.C. are considered. For instance, we note that the Jakarta and Tokyo hotels have been opened since 1979 and 2005 respectively, and although we do not have the historical costs for these hotels, we believe they could have appreciated in value as well. We therefore reiterate our view that Mandarin Oriental is undervalued at its current share price.

(II) Peer comparison analysis

We also performed a peer comparison study to analyse how Mandarin Oriental is performing relative to its peers. We selected the peer companies, as shown in **Exhibit 35**, based on how similar they are in terms of industry and business operations to Mandarin Oriental. The selected peers are all within the hotel industry and have business operations in hotel ownership and management.

Exhibit 35: Peer comparison

Company	SGX code	Current price (US$) as at 22/6/20	Market cap (US$ million) as at 22/6/20	EPS [1] (cents)	P/E (x)	DPS [2] (cents)	Dividend yield (%)	NAV per share [3] (S$)	P/B (x)
Mandarin Oriental Intl Ltd [4]	M04	1.460	1,844.27	3.26	44.79	3.00	2.05	3.26	0.45
Peers:									
CDL Hospitality Trust [5]	J85	1.090	1,326.09	9.27	11.76	9.02	8.28	1.52	0.72
Far East Hospitality Trust [5]	Q5T	0.525	1,021.55	3.15	16.67	3.81	7.26	0.86	0.61
Frasers Hospitality Trust [5] [6]	ACV	0.490	935.75	1.87	26.20	2.50	5.11	0.71	0.69
Hotel Properties Limited [5]	H15	3.200	1,668.77	9.35	34.22	4.00	1.25	3.82	0.84
Shangri-La Asia Limited [7]	S07	6.500	23,305.75	32.85	19.79	8.00	1.23	13.31	0.49
Peer average	-	-	-	-	21.73	-	4.62	-	0.67

Figures have been rounded.

P/E, P/B and dividend yield computed based on respective current prices

(1) Diluted EPS based on trailing earnings over the last 4 quarters or last released annual dividends

(2) Annual dividends for the latest financial year for the respective companies

(3) As at 31 Dec 2019.

(4) EPS is based on underlying profit attributable to shareholders of US$41.2 million.

(5) Company data in SGD

(6) Company financial year ends on 30 Sep. DPS based on dividends in the last 4 quarters. NAV per share as at 31 Mar 20.

(7) Company data in HKD. EPS and NAV per share are converted from USD to HKD based on currency rate of HKD 1=USD 0.13

Source: Compiled using data from the respective companies

With reference to **Exhibit 35**, we first note that Mandarin Oriental's P/E of 44.79x is higher than the peers' average P/E of 21.73x. This could be due to the nature of the Group's business and we note that the Group's business is primarily driven by its owned and partially owned properties. Hotel ownership would involve incurring interest costs from the purchase of land to build the hotels and having to endure zero revenue income during the hotels' construction period. This would therefore depress earnings until the hotels are completed and begin to generate revenue. Assuming no drastic changes in the share price, this would result in a higher P/E.

We also note that Mandarin Oriental's P/B ratio of 0.45x is lower than the peer average of 0.67x. This supports our earlier conclusion that Mandarin Oriental is undervalued. We further note that Mandarin Oriental's dividend yield of 2.05% is lower than the peers' average of 4.62%. Owning to the impact of COVID-19, Mandarin Oriental had withdrawn recommended final dividends of 1.50 US cents that were scheduled for payment on 13 May. As of writing, we note that the peers have not announced any withdrawal of dividends. However, it is likely that they may reduce their dividends given the adverse COVID-19 impact.

Given the peer comparison analysis, we adopted a relative valuation method using the peers' average P/B multiple as a benchmark. In other words, we estimate a target price for Mandarin Oriental if its P/B were to adjust to the peers' average of 0.67x. If Mandarin Oriental is to trade at 0.67x, as shown in **Exhibit 35**, the target price would be US$2.18, which would generate a potential upside of 49.3% from the current price of US$1.46. Our estimations are as follows:

- Target price = [peers' average P/B] x [NAV per share] = 0.67 x US$3.26 = US$2.18
- Potential upside from current price = [US$2.18/US$1.46] – 1 = 49.3%

Our estimated target price of US$2.18 implies a 33.1% discount to the NAV per share of US$3.26. This could be a conservative estimate of the target price as we note that the NAV per share of US$3.26 in **Exhibit 31** may be low due to the adoption of the historical cost convention. We have supported this with our revaluation example as discussed earlier.

SWOT AND COMPETITIVE ANALYSIS

In this section, we undertake a SWOT analysis in **Exhibit 36** to evaluate the various components of the analysis thus far.

Exhibit 36: SWOT analysis

SWOT analysis	
Strengths • Robust corporate structure • Strong financial capabilities • Brand value	Weaknesses • Focus on affluent customer base
Opportunities • Hotel management opportunities from member companies	Threats • Prolonged restrictions on travel • Risk of currency fluctuations • US-China tensions

(I) Strengths

Mandarin Oriental is a member of the Jardine Matheson Group (Jardine Group), comprising Jardine Matheson Holdings Limited and its subsidiaries. The Jardine Group is a diversified Asian-based group with business operations in a broad range of sectors. As at 31 December 2019, the Jardine Group had approximately total assets of US$97.0 billion and total equity attributable to shareholders of US$30.4 billion. As at time of writing, the Jardine Group has a market capitalisation of approximately US$30.9 billion. Other members of the Jardine Group include Jardine Strategic Holdings Limited (Jardine Strategic), Hongkong Land Holdings Limited (Hongkong Land) and Dairy Farm International Holdings Limited. Jardine Strategic holds most of the Jardine Matheson Group's major listed interests, including a 78% effective ownership in Mandarin Oriental as of 5 March 2020. We note that Mandarin Oriental is well-positioned within a robust corporate structure to benefit from strong financial support and brand reputation from the Jardine Group. Further, we note that Mandarin Oriental is able to benefit from opportunities within the Jardine Group. We will elaborate on this further in the 'Opportunities' section of our SWOT analysis.

As noted in the Catalyst section on page 24, Mandarin Oriental had in 2017 tested market interest in the possible sale of The Excelsior hotel in Hong Kong, where it received proposals from potential purchasers to acquire the property. Mandarin Oriental eventually chose not to sell the property and decided to demolish The Excelsior hotel and redevelop the site. We think that Mandarin Oriental's decision reflects the Group's strong financial capabilities, given the ability to finance the redevelopment and forego potential proceeds of US$3.8 billion from the hotel sale.

We also note that the Group's hotels have received international awards, reflecting the strong value of the Mandarin Oriental brand. For instance, the Group's Tokyo and Bangkok hotels were featured in Conde Nast Traveller's Gold List in 2018 and 2019, respectively. Additionally, many of the Group's hotels were also featured in the Forbes Travel Guide 2019. Further, the Mandarin Oriental brand was ranked second in Luxury Travel Intelligence's (LTI) list of top luxury hotel brands in 2019. We also note that properties under the Mandarin Oriental brand have been acquired by wealthy investors and transacted at high prices. It was reported that Mandarin Oriental, Taiwan had been acquired by Hong Kong billionaire Calvin Lo in 2019 for approximately US$1.25 billion. This shows that hotels under the Mandarin Oriental brand tend to be highly coveted.

(II) Weaknesses

We note that the Group's luxury hotels are catered towards affluent customers who can afford to pay higher hotel accommodation costs. This could be a potential weakness during periods of weak economic sentiment as we are in at the moment. Demand for travel, and in turn hotel stays, will be softer when economic conditions are poor. This is further exacerbated in the unprecedented situation we are currently facing, where travel is limited due to the imposition of travel restrictions. Being in the luxury hotel segment, Mandarin Oriental's business is more susceptible to weak economic conditions, as demand for luxury hotel stays will be severely impacted as consumers may opt for more affordable hotel stays. Further, we note that the impact on luxury hotels is potentially greater during this COVID-19 pandemic as business travelling is greatly impeded.

(III) Opportunities

As noted in the 'Strengths' section of our SWOT analysis, Mandarin Oriental is responsible for the management of The Landmark Mandarin Oriental hotel in Hong Kong which is owned by Hongkong Land, a fellow member within the Jardine Group. We think that there is a potential for more of such opportunities for Mandarin Oriental in the near future. It was recently reported that Hongkong Land had acquired for 31 billion yuan a prime mixed-use site on the West Bund of Shanghai early this year, which will be used primarily for Grade-A office, retail, residential and hotel purposes. We note the potential for Mandarin Oriental to manage the hotel in Shanghai, given the precedent of managing Hongkong Land's The Landmark Mandarin Oriental hotel.

(IV) Threats

The COVID-19 pandemic has led to severe impact of the hotel sector in countries all over the world. The Group's performance will very much be determined by the duration and impact of COVID-19. The main concern is a prolonged fight against the virus, which will imply longer restrictions on travel. This will negatively affect the demand for hotel stays.

INVESTMENT RECOMMENDATION

Based on Mandarin Oriental's reported book value as at 31 December 2019, it currently has a low P/B of 0.45x and is trading at a 55.0% discount to its book value, which could indicate that the company is potentially undervalued at the current share price.

We note that Mandarin Oriental adopts a historical cost convention in reporting the value of its assets, which we believe supports our view that the company is undervalued. We performed, as an example, a revaluation of the Group's London, Paris and Hong Kong hotels to support our view. From our revaluation of the 3 hotels, we derived an estimated valuation surplus of US$2,696.1 million. A balance sheet adjustment was then performed to include the valuation surplus, where we then achieved an adjusted P/B of 0.27x. We note that our adjusted P/B of 0.27x is lower than the 0.45x based on Mandarin Oriental's reported balance sheet. This shows that Mandarin Oriental could be more undervalued if the appreciation value of its hotels were included in the balance sheet. We therefore reiterate from our revaluation example that Mandarin Oriental is undervalued at its current share price.

Our peer comparison analysis shows that Mandarin Oriental's P/B of 0.45x is lower than the peers' average of 0.67x. This further supports our view that the company is undervalued. We adopt a relative valuation to derive an estimated target price of US$2.18 if Mandarin Oriental's P/B were to readjust to the peers' average benchmark of 0.67x. Our target price implies a potential upside of 49.3% from the current share price of US$1.46. Our target price also implies a 33.1% discount to the NAV per share of US$3.26 as at 31 December 2019.

We note that the COVID-19 pandemic will potentially weigh on hotel revenue and thus the Group's financial performance would be weaker in 2020. In 2021, however, hotel markets are expected to rebound and we expect the Group's revenue and earnings to recover amid a recovery in hotel occupancy and RevPAR. Further, we identify potential catalysts such as the redevelopment of The Excelsior site and the Group's pipeline of development projects, which will underpin revenue and profit growth.

Given the above considerations, we believe a buy is warranted on Mandarin Oriental, especially given the sharp sell-down due to COVID-19. We therefore issue a buy recommendation and our target price is US$2.18 per share. However, there are still risks to our target price which we will highlight in the Risk section.

RISKS TO OUR TARGET PRICE

(I) Prolonged restrictions on travel

Since the outbreak of COVID-19 in 2020, countries worldwide have imposed measures such as travel restrictions to control the spread of the virus. This had led to a drastic decline in international and domestic travel which have severely impacted aviation, tourism and hospitality sectors. Lower travel has reduced the demand for hotel accommodation, bringing hotel occupancy rates down to unprecedented levels. This negatively impacted hotel revenue performance.

Given the widespread impact of COVID-19, Mandarin Oriental has been adversely impacted as the Group recorded an underlying loss of US$40 million in the first quarter of 2020. Industry projections are predicting a recovery in hotel markets in 2021, given the expected re-opening of economies. However, the virus situation remains uncertain and we may be in for a long-drawn fight against COVID-19. This will lead to prolonged restrictions on travel which will weigh on hotel revenue.

(II) Risk of currency fluctuations

Given the widespread geographical exposure of the Group’s portfolio, there is exposure to foreign exchange risk due to currency fluctuations. There could thus be potential losses incurred from currency translation. In 2018, the Group had reported a net loss of US$39.7 million from exchange translation differences. Amid the COVID-19 pandemic, the US dollar is expected to strengthen due to its safe-haven currency status. This will imply reduction in revenue when foreign currency earnings in Pound sterling and Euros are translated into US dollar.

(III) US-China tensions

The COVID-19 pandemic has strained US-China relations as both countries have been playing the blame game on the origin of the virus. Further, uncertainty remains over the US-China trade situation and new tensions have surfaced due to China’s decision to impose a new security law in Hong Kong and US investor-protection concerns over the auditing on Chinese companies that are listed on US stock exchanges. As evident from the impact of the US-China trade war, we are concerned of the negative ripple effects from such tensions on the global economy and markets. This may severely affect Mandarin Oriental’s revenue due to lower business travelling.

SUSTAINABILITY INFORMATION

As part of its sustainability efforts, Mandarin Oriental is committed to maximising social and economic benefits for the communities where its operates, responsibly managing its environmental impact and fulfilling its social commitments within its operations and across its supply chains.

Guiding Principles

Through its 5 Guiding Principles, Mandarin Oriental illustrates how it aspires to engage all its stakeholders, from guests and colleagues to all partners, in its relentless pursuit of sustainability and hospitality excellence. The following table in **Exhibit 37** shows the 5 Guiding Principles and description of each principle.

Exhibit 37: Guiding Principles

Guiding Principle	Description
Delighting our Guests	We are committed to exceeding guest expectations by surprising them with our ability to anticipate and fulfil their wishes when it comes to sustainability
Delighting our Colleagues	We value each colleague and provide a caring, inclusive, motivating and rewarding environment for all. We bring out the best in our people through effective training and personal development, enabling a fulfilling career with the Group.
Acting with Responsibility	We maintain integrity, fairness and honesty in all our internal and external relationships. We support initiatives that improve the environment and are responsible members of our communities
Working Together	We emphasise the importance of teamwork and treat each other with mutual respect and trust. By working cooperatively with both internal and external parties, we contribute to the Group’s success and the sustainable development of cities where we are located.
Becoming the Best	We intend to be an innovative leader in the luxury hospitality industry. We constantly improve our service delivery, as well as the quality of our products and facilities, ensuring that we appeal to our multi-generational audience.

Source: Compiled from Mandarin Oriental's Sustainability Report 2019

Sustainability Governance

Mandarin Oriental has a robust 4-tier governance framework, in particular the formation of thematic working groups, that has successfully driven multiple sustainability initiatives. By the end of 2019 a total of 8 working groups had been activated, each of which sets its own targets and goals in support of the Group's broader sustainability objectives, identifying industry-wide best practices, as well as facilitating cross-pollination of innovative ideas among sister hotels. The following diagram in **Exhibit 38** illustrates the Group's governance framework and the function of each entity within the framework.

Exhibit 38: Sustainability governance framework

Executive Advisory Panel

Chaired by our CEO, it defines key priorities for the Group and provides both resources and mechanisms for sustainability

Sustainability Leadership Council

Composed of Group-and property-level colleagues, it filters thematic priorities into work streams and focused action points to be implemented by the Working Groups

Hotel Champions & Sustainability Committees

Each hotel has established a Committee composed of colleagues who are passionate about sustainability. Through leveraging Group-wide sustainability program resources, they are then empowered to implement location-specific, innovative initiatives.

Working Groups

Composed of Group-and property-level colleagues, they address specific sustainability topics. Eight Working Groups are currently active

Source: Compiled from Mandarin Oriental's Sustainability Report 2019

The Group's 8 active Working groups and their focus areas in 2019 are detailed in the following diagram in **Exhibit 39**.

Exhibit 39: Guiding Principles

WORKING GROUP	FOCUS AREAS 2019
Hotel Sustainability Committee (HSC) Support	Provide HSCs support, including in the areas of sustainability training and sharing best practices
Guest Engagement	Identify ways to integrate sustainability into guest engagement
Human Rights and Inclusiveness	Develop anti-human trafficking and modern slavery policies and practices and monitor gender diversity
Food & Beverage Impact	Eliminate single-use plastic and identify responsible procurement opportunities in Food & Beverage (e.g. coffee, tea, seafood)
Green Spas	Eliminate single-use plastic and identify responsible procurement opportunities in Spas
Measurement and Reporting	Oversee the annual sustainability report, related online data-gathering platforms and implement online sustainability management system
Green Development	Identify ways to integrate sustainability throughout hotel development, design, and pre-opening phases
Responsible Procurement	Maximise opportunities in responsible procurement and support the implementation of responsible procurement programmes and related policies

Source: Mandarin Oriental Sustainability Report 2019

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