FOCUS

15th June 2016

Melia Hotels

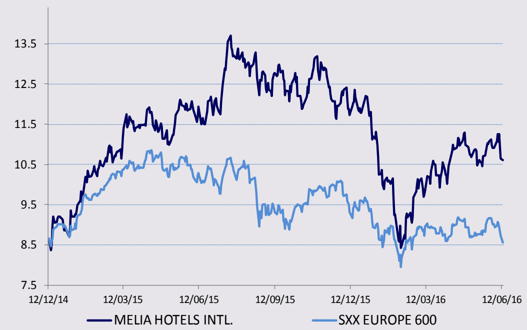
The best place to be under the sun

Hotels

Fair Value EUR15 (price EUR10.31) **BUY-Top Picks**

Bloomberg	MEL SM
Reuters	MELL.MC
12-month High / Low (EUR)	13.7 / 8.4
Market capitalisation (EURm)	2,368
Enterprise Value (BG estimates EURm)	2,857
Avg. 6m daily volume ('000 shares)	732.7
Free Float	47.3%
3y EPS CAGR	44.9%
Gearing (12/15)	58%
Dividend yield (12/16e)	0.51%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	1,738	1,837	1,981	2,126
EBIT (EURm)	164.10	174.05	202.00	227.68
Basic EPS (EUR)	0.19	0.34	0.50	0.59
Diluted EPS (EUR)	0.19	0.34	0.50	0.59
EV/Sales	1.80x	1.55x	1.46x	1.36x
EV/EBITDA	10.7x	10.2x	9.1x	8.2x
EV/EBIT	19.1x	16.4x	14.3x	12.7x
P/E	53.2x	30.3x	20.8x	17.5x
ROCE	5.2	5.3	5.9	6.4



The short- and medium-term results perspectives look positive with an operating improvement clearly identifiable. Moreover, with new-found financial health, the group's expansion should be boosted with new selective fully-owned property beyond the current pipeline, which is almost entirely under management contracts. We are confirming our positive opinion with a FV of EUR15.

- **An improvement in operating results is clearly identifiable:** For the next three years, we estimate an operating results CAGR of c. 13%. The improvement in the operating results should come not only mainly from **Spanish cities** (EUR30m), but also from **Asia** (EUR10m) where short-term pipeline should improve Asia's EBIT contribution substantially, the area having now reached critical mass and breakeven, and **Cuba** (EUR10m) benefiting from the reopening relations with USA where Melia is definitely the leading resort hotel company with a 21% market share in number of rooms (27% of the total number of stays).

- **A new-found financial health:** Based on our estimates, taking into account cash flow generation and the early redemption of the convertible bonds finalised in mid-May, the net debt/EBITDA w/o asset rotation should be 1.7x, compared with 3.1x at the end of 2015 and management's objective of lower than 3x at the end of 2016.

- **Yet again, new opportunities for the expansion of hotels in fully-owned property:** Assuming that normal financial leverage should be around 2.5x and taking into account that management estimates that there is EUR300m worth of non-core assets, Melia has potentially EUR500m for new development in fully-owned property (not yet included in our forecasts) ahead of the current pipeline mostly under management contracts.

- **A FV of EUR15:** Based on our estimates and using a DCF with a WACC of 6.7%, an ERP of 7%, a risk-free rate of 1.6% with a beta of 0.9 (two years historical adjusted vs. Stoxx), long-term growth of 2.5% and an EBIT margin of 10% (9.5% in 2015), we are confirming our FV of EUR15.

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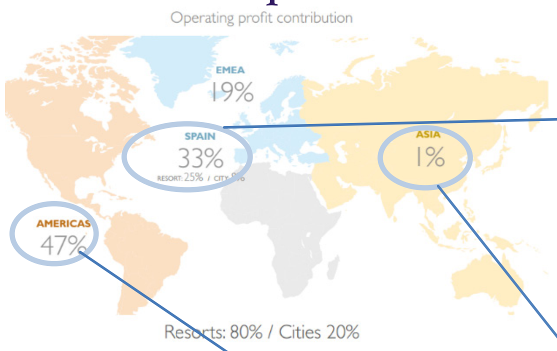
Melia Hotels Major keys to Focus on

1. One Graph



Where EBIT could be improved?

- **Spanish cities should help improve the group's EBIT by at least 15%.** Actually, with 22% of the total group's number of rooms, the EBIT contribution is only 8%. In 2015, RevPAR was about 12% lower than in 2007, previous RevPAR highs. In 2016, RevPAR is likely to be not far off previous RevPAR highs but EBIT will again be lower by around EUR30m (i.e. representing 18% of 2015's consolidated EBIT of EUR164m) compared to 2007 with a still less favourable split between occupancy and daily rate.

- **Critical mass finally reached in Asia:** Melia's current portfolio is 11 hotels with c. 3,000 rooms, i.e. 4% of the total number of rooms generating 1% of consolidated EBIT. New openings represent 7 hotels in 2016, 6 in 2017 and 3 in 2018 which should improve Asia's EBIT contribution substantially, having now reached critical mass and breakeven.

- **Cuba, one of the drivers in the Americas:** With 29 hotels under management and some 15,500 rooms, Melia's market share is 21% in the number of rooms and 27% in the number of stays. The EBIT contribution was c.EUR18m in 2015 vs. EUR13m in 2014. Management says EBIT could improve by at least EUR10m in the next two years (i.e. 6% of consolidated 2015 EBIT). Moreover, Melia has today 3 hotels in its pipeline with openings scheduled in 2018.

- **Sustained pipeline mainly through management contracts:** All in all, the current pipeline is over 16,000 rooms representing 19% of the current portfolio, o/w 85% is under management contracts and 15% under variable lease contracts, 96% in the premium and upscale segments and nearly 100% outside Spain.

In summary, there is around EUR50m that could be added to the consolidated EBIT in the next 2 to 3 years, to be compared with a 2015 EBIT of EUR164m. Compared with consensus, our estimates are in line 2016e, 2% higher in 2017e and 7% in 2018e.

2. One Sentence

« melia.com and customer knowledge as a key lever for income generation »

- **Consolidation of Melia's direct channels:** With 26% of consolidated Hotels revenue, melia.com now represents the main distribution channel ahead of OTA (25%) and TO (25%). Nevertheless, management's goal is to reach 40% in the next three years. To reach this, Melia has mandated Accenture and will spend, mainly on opex, EUR12m in 2016 and EUR15m per annum in the next two years.

- **melia.com** generated EUR337m of total hotel room revenue and management's short-term expectation is for EUR445m in 2016. The direct channel for hoteliers is crucial to create a personalised relationship with customers, to improve the loyalty programme (81% of total revenue generated via melia.com coming from client members of Melia Rewards) bearing in mind that Melia Rewards members spent 12% more than non-members. Finally, melia.com's cost base represents around 7% of total room revenue compared with 17% of total cost from OTAs.

3. Two Figures

1.7 and 500

- Deleveraging the balance sheet was one of the main objectives in recent years. At the end of 2015, the net debt/EBITDA w/o capital gains ratio reached 3.1x. Management's goal was for below 3x in 2016. Following the decision to force the early redemption of the convertible bonds finalised in mid-May (EUR250m), debt is no longer an issue. In fact, the group's debt position will improve significantly with the n**et debt/EBITDA w/o capital gains ratio falling to 1.7x on our estimates at the end of 2016**. Moreover, this multiple could give the group the opportunity to optimise its average cost of debt which was 4.4% in 2015 (4.8% in 2014).

- Beyond this, such a low ratio gives the group new expansion opportunities. In fact, if we consider that the normal financial leverage should be around 2.5x for the Melia Hotels portfolio, this is almost EUR200m that could be invested in new developments in fully-owned property.

- Moreover, management confirmed to us that on an assets gross value of over EUR3.1bn (Jones Lang LaSalle Hotels estimate as of June 2015), about 10% is non-core, i.e. EUR300m (including the Porto Rico hotel for USD80m, a plot of land in Brazil for EUR75m, two hotels in the Canary Islands and hotels in secondary cities in Spain) and could also be used for expansion. Remember that owned hotels represents 18% of the group offer, hotels under lease contracts 24% and management & franchise 58%.

In summary, the group's new financial resources for expansion could reach at least EUR500m.

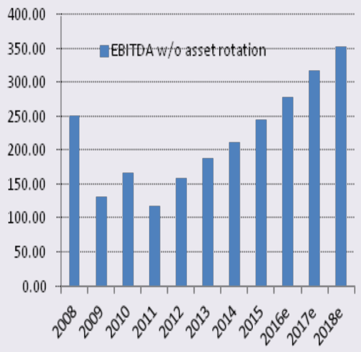
4. How does it impact our Investment Case

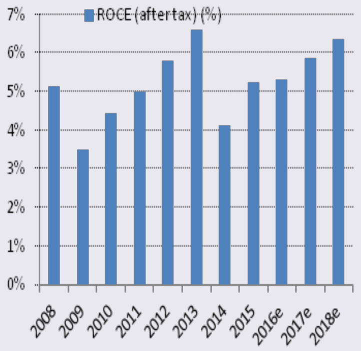
- Following the Q1 results in early May, our roadshows (Paris, Geneva and Luxemburg) and the early redemption of the convertible bonds with the issue of around 30.6m new shares, we are confirming our positive view and our FV of EUR15 per share. Note that the short-term stock price could be impacted by this share issue.
- After the Q1 results and RevPAR of 10.7%, mainly driven by ADR, management upgraded its expectation for the FY to a mid to high single-digit RevPAR increase vs. mid single-digit previously, notably due to a continuing improvement in Spain (RevPAR was up 21% in Spain in Q1). Regarding RevPAR, note that the decrease in America of 1% in Q1 nevertheless has a positive impact on EBITDA as it was mainly due to lower occupancy (-5.5%pts) while ADR was up 6.4%.
- Melia's confidence in the short-term results was confirmed during our roadshows but, more importantly the group's expansion strategy sounded clearer and aggressive, which is likely to be related to its renewed financial health.
- For the next three years, we are confirming our forecasts which should deliver an EBITDA 2015-2018 CAGR of 12.9%. At the current share price, the stock is valued at 10.5x EV/EBITDA 2016e and 9.3x 2017e.

Next Catalysts

Period		
H1 2016	results	on 1st August
Q3 2016	results	on 7th November

Source: Company Data; Bryan, Garnier & Co ests.





Company description

Founded in 1956 in Palma de Mallorca, Spain, Meliá Hotels International is one of the largest hotel companies in the world and the largest hotel chain in Spain in both resort and city hotels. The company currently operates more than 350 hotels in 35 countries and 4 continents under its brands: Meliá, Gran Meliá, ME by Meliá, Paradisus, Innside by Meliá, TRYP by Wyndham, Sol Hotels and Club Meliá.

Shareholders (%)	
Escarrer Family	52.0
Treasury shares	0.7
Free Float	47.3

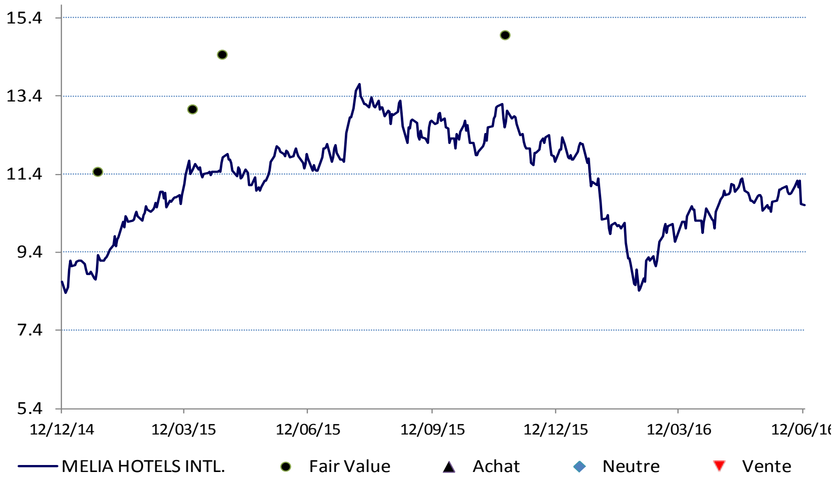
Source: Company Data;

Income Statement (EURm)	2013	2014	2015	2016e	2017e	2018e
Sales	1,369	1,495	1,738	1,837	1,981	2,126
% Change	*2.9%*	*9.2%*	*16.3%*	*5.7%*	*7.8%*	*7.3%*
EBITDA	239	227	293	280	318	354
Rental expenses	107	126	144	147	154	162
EBITDAR	346	353	437	427	472	516
Depreciation, amortisation and provisions	91.1	96.5	129	106	116	126
EBIT	175	131	164	174	202	228
% Change	*4.4%*	*-25.2%*	*25.5%*	*6.1%*	*16.1%*	*12.7%*
Financial result	(187)	(66.0)	(58.5)	(50.3)	(27.1)	(22.1)
Profit before exceptionals and tax	(12.3)	64.8	106	124	175	206
Exceptional items	(3.9)	0.0	0.0	0.0	0.0	1.0
Tax	(9.2)	(25.0)	(61.1)	(35.6)	(51.0)	(60.2)
Earnings from associates (before tax)	(17.8)	(9.2)	(3.9)	(5.0)	(5.0)	(5.0)
Minority interests	(2.1)	(1.5)	(4.5)	(5.0)	(5.0)	(5.0)
Reported net attributable profit	(41.4)	29.1	36.1	78.1	114	135
Adjusted net attributable profit	(41.4)	29.1	36.1	78.1	114	135
% Change	*-191%*	*-170%*	*24.1%*	*116%*	*45.8%*	*18.9%*
Cash Flow Statement (EURm)						
Debt, y-1	1,002	1,158	984	769	489	523
- Cash flow	120	188	271	244	267	294
+ Change in WCR	7.9	(298)	(27.2)	(19.5)	(28.3)	(28.4)
+ Net capex	(105)	(13.3)	39.3	(220)	(220)	(220)
Free cash flow	22.9	(123)	283	4.8	18.4	45.5
+ Net financial investments	0.60	0.10	1.3	0.0	0.0	0.0
+ Dividends	(7.7)	(7.4)	(6.9)	(10.0)	(12.0)	(13.0)
+ Other/Miscellaneous	(171)	304	(61.9)	285	(40.9)	(35.9)
= Net debt	1,158	984	769	489	523	526
Balance Sheet (EURm)						
Tangible fixed assets	1,567	1,640	1,551	1,625	1,692	1,753
Intangibles assets	139	138	159	166	173	179
Cash & equivalents	437	337	349	114	12.4	(67.8)
current assets	495	403	419	442	477	512
Other assets	737	699	682	715	744	771
Total assets	3,374	3,216	3,159	3,062	3,099	3,147
L & ST Debt	1,111	1,341	1,189	799	748	686
Others liabilities	1,095	607	656	571	616	661
Shareholders' equity, 100%	1,169	1,268	1,314	1,691	1,736	1,800
Total Liabilities	3,374	3,216	3,159	3,062	3,099	3,147
= Capital employed	1,859	2,224	2,190	2,298	2,407	2,507
Financial Ratios						
Operating margin (%)	12.78	8.75	9.44	9.47	10.20	10.71
Net financial charges/EBIT (x)	(1.07)	(0.50)	(0.36)	(0.29)	(0.13)	(0.10)
Tax rate (%)	(74.80)	38.58	57.86	28.79	29.14	29.27
Net margin (%)	(3.02)	1.95	2.08	4.25	5.75	6.37
ROE (after tax) (%)	(3.36)	2.41	3.09	4.92	6.85	7.80
ROCE (after tax) (%)	6.59	4.12	5.25	5.30	5.88	6.36
Gearing (%)	99.06	77.61	58.49	28.89	30.13	29.24
Payout ratio (%)	18.60	(25.43)	(19.11)	(12.80)	(10.53)	(9.60)
Number of shares, diluted (000)	229,700	229,700	229,700	229,700	229,700	229,700
Data per Share (EUR)						
Reported EPS	(0.41)	0.17	0.19	0.34	0.50	0.59
Adjusted EPS	(0.24)	0.19	0.19	0.34	0.50	0.59
% change	*-192%*	*-180%*	*0.0%*	*75.5%*	*45.8%*	*18.9%*
BV/share	5.09	5.52	5.72	7.36	7.56	7.84
CF/share	0.52	0.82	1.18	1.06	1.16	1.28
FCF/share	0.07	0.76	0.48	0.11	0.20	0.32
Net dividend/share	0.03	0.03	0.03	0.05	0.06	0.06

Source: Company Data; Bryan, Garnier & Co ests.

Price Chart and Rating History

Melia Hotels



Ratings		
Date	**Ratings**	**Price**
31/07/13	BUY	EUR6.45
13/11/12	SELL	EUR5.58
26/09/11	NEUTRAL	EUR4.7
24/06/11	BUY	EUR7.9

Target Price	
Date	**Target price**
04/11/15	EUR15
09/04/15	EUR14.5
18/03/15	EUR13.1
07/01/15	EUR11.5
09/01/14	EUR11
08/11/13	EUR10
31/07/13	EUR7.2
15/01/13	EUR5.8
15/11/12	EUR5.7
15/05/12	Under review
21/11/11	EUR6.6
28/09/11	EUR7.7
24/06/11	EUR9.7

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SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 55,8%   NEUTRAL ratings 34,7%   SELL ratings 9,5%

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