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The hotel asset-light model

The asset light model has become increasingly popular, but is it a truly a boon for investors?

Why are hotels turning to an asset-light model?

An asset-light model, based on management and franchise contracts, reduces capital intensity and attendant investment risk while allowing brands to achieve scale rapidly (a crucial element of online visibility) without the exorbitant start-up losses.

Also, investors' perception of the model's stability and high margins may drive premium multiples. As a result, for international hotel groups an asset-light strategy has become the model of choice.

However, for investors, property ownership in markets of sustained popularity provide not only scope for meaningful asset appreciation but also a strong backstop in the event of trading disappointment due to tough conditions and a predominant value indicator. This raises questions about the benefits of asset-light models to investors.

What are some of the risks inherent in an asset-light model?

An asset-light model is all well and good, but in practice there remain constant changes in ownership structure as, for example, at core locations where tenure and returns may be maximised by a move from management contracts to leases.

Similarly, at a time of increasing brand homogeneity and in competitive markets, the assumption of some operational risk or offer of commitment, be it by lease or investment in the form of minimum guarantees or key money, may win the day with owners. This may provide an incentive for them to keep control of their assets rather than pivot to an asset-light model.

Furthermore, the regaining of some control over properties, forsaken particularly by franchising, is conducive to enhancing brand identity and guest satisfaction.

The prize of market entry or accelerated roll-out should thereby trump the drawbacks of strategic rigidity.

Edison Insight

'The asset-light trend by hotel companies masks the potential for creating shareholder value through developing, owning and operating hospitality real estate. Fortunately this potential is gaining prominence thanks to increasing disclosure of fair value and thus true share price discount to NAV.'

Richard Finch,
Leisure Analyst

What are the risks of an asset-light model to investors?

For property-rich hotel companies, the traditional investor focus on the EV/EBITDA marker of operating performance risks overlooking another key benchmark, NAV per share, with potentially substantial reserves hidden by the statement of their assets at historical cost.

EPRA reporting or a policy of annual value in use assessments has highlighted marked share-price discounts to NAV.

As for cyclical concerns, the threat of hard-to-sell assets and excessive debt is understandable.

However, for those owner/operators in key lodging markets, possibly with trophy assets, the enduring appetite of international buyers in particular may just as reasonably be relied on to mitigate trading concerns. This was epitomised by ownership changes at London-oriented Thistle Hotels during successive market downturns.

Finally, at the risk of cynicism, the appeal of asset-light to investors may have been exaggerated by the lure of special dividends on key disposals. This is forgivable as long as investors also bear in mind that assets can be sold only once.

How have companies implemented an asset-light strategy?

Marriott led the way in 1993 by spinning off its real estate into an investment trust (Host Marriott).

Not only did this free Marriott from the burden of debt during the industry downturn of the late 1980s, but it spurred the company's aggressive growth into the largest lodging business in the world, from 500 properties to around 7,000.

Other hotel groups followed, notably IHG, whose sale of the landmark InterContinental Hong Kong in 2015 completed the disposal of its major owned assets and thus the release of almost $8bn in gross proceeds from around 200

30/05/19

hotels since 2003 and the return of over $10bn to shareholders.

More recently, in early 2017 Hilton focused its model on its capital-efficient fee business by completing spin-offs of a portfolio of hotels and its timeshare business into two independent, publicly traded companies: Park Hotels & Resorts and Hilton Grand Vacations.

Meanwhile AccorHotels has used the sale of a majority stake in its owned and leased hotel business (AccorInvest) both to expedite hotel growth and invest in related markets such as co-working spaces, concierge services and digital booking platforms.