PPHE Hotel Group

Mind the gap

Company re-appraisal

Travel & leisure

In keeping with its strong record of asset development, PPHE is actively repositioning itself at the corporate level. The introduction of EPRA reporting highlights the company's success from a property perspective (EPRA NAV per share of £24.57 at December 2018), while share liquidity and broadening of the investor base should benefit from the recent secondary placing and move to a Premium Listing. Operationally, progress is robust with resilient trading (8% gain in Q1 like-for-like RevPAR and revenue), continued material investment payoff and abundant asset-acquisition opportunities. We believe PPHE's shares offer an attractive way to access hotel property markets, particularly in London and the Netherlands, both in terms of capitalisation yield and a SOTP valuation.

Year end	Revenue (£m)	EBITDA (£m)	Adj. EPS* (p)	EPS** (p)	DPS (p)	EV/EBITDA (x)
12/17	325.1	107.3	104.0	64.2	24.0	10.4
12/18	341.5	113.2	115.0	77.5	35.0	10.5
12/19e	350.0	118.0	114.0	74.5	40.0	10.3
12/20e	365.0	122.5	122.0	83.5	45.0	10.0

Note: *EPRA (IFRS depreciation charge replaced by maintenance capex charge of 4% of revenue), excluding exceptional items. **Normalised, excluding amortisation of acquired intangibles and exceptional items.

Favourable newsflow

PPHE has accompanied news of a 'strong' Q119 and a confident statement with confirmation of a £240m committed investment programme, including a joint venture for art'otel to enter the lucrative New York boutique market. In turn, the sale by three major shareholders of a total 22% holding via a placing at 1,600p should provide the free float required to qualify for inclusion in the FTSE UK series of indices. Further good news is on the cards as financial flexibility offers ample scope for value accretive expansion (18% CAGR in EPRA NAV since 2010) and management has a proven record on development and reluctance to pay up.

Positive forecasts

Our 2019 forecast is maintained in view of this good start to the year, sensible precautions about Brexit and accelerating payoff from significant investment, notably at Riverbank, Victoria Amsterdam and Croatia glamping. We expect more of the same next year as current projects come on stream. The likely positive joker in the pack is expansion.

Valuation: Narrowing the discount

EPRA reporting should enhance recognition of PPHE's investment case by highlighting substantial hidden reserves. EPRA NAV per share of £24.57 at December 2018 means an excess of c £700m over book value. Likely investment should accentuate this materially, given the strong development record. According to our estimates the share price implies a capitalisation yield on PPHE's properties of 7%, compared with c 5% weighted average prime yield in the company's markets. Applying a 20% discount to NAV (as typically traded now by US Hotel REITs) to our SOTP valuation gives £23.18 as PPHE's value per share.

1 May 2019

Price	**1,690p**
Market cap	**£715m**

Net bank debt (£m) at December 2018	479.6
Shares in issue	42.3m
Free float	50.4%
Code	PPH
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	2.4	(4.0)	45.3
Rel (local)	0.2	(9.7)	47.4
52-week high/low		1,800p	1,155p

Business description

As an international real estate hospitality company, PPHE Hotel Group is principally an integrated owner and operator of upscale and lifestyle hotels in gateway cities and regional centres as well as hotels, resorts and campsites in select resort destinations.

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Investment summary

Company description: Developer, owner and operator of hotels

As an international real estate hospitality company, PPHE is principally a developer, owner and operator of upscale and lifestyle hotels in gateway cities and regional centres as well as hotels, resorts and campsites in select resort destinations. Its portfolio comprises 28 hotels (c 7,300 rooms) under the brands Park Plaza Hotels (exclusive partnership with Radisson Hotel Group in EMEA) and art'otel (owned). Its first premium boutique hotel Holmes (previously Park Plaza Sherlock Holmes) opens in May. Its subsidiary Arena Hospitality also operates nine hotels and resorts (c 1,400 rooms) and eight campsites (c 6,000 pitches and mobile homes) in Croatia. The openings pipeline (c 700 rooms by 2023) includes an owned art'otel at Hoxton, London, art'otel management contracts at other high-profile regeneration areas, Battersea Power Station, London and Hudson Yards, New York (part owned) and an owned unbranded hotel in Belgrade (subject to completion of transaction). PPHE transferred last year to a Premium Listing on the London Stock Exchange; it floated on AIM in 2007, moving to the Official List in 2011.

Valuation

According to our estimates, the current share price implies a capitalisation yield on PPHE properties of 7.0% (after adjusting for the value of Hoxton project and PPHE's hotel management business). This compares with a weighted average prime yield in the company's markets of c 5%. Since the properties are predominantly in prime locations and well invested, we believe this suggests the market is not fully discounting the actual value of the portfolio. It is instructive to examine a sum-of-the-parts valuation, which includes PPHE's net property value estimate provided by independent valuation (currently at £24.57 per share) based on forecast earnings at the property level, as well as our valuation of the company's Management and Central Services division. We understand that US Hotel REITs may be currently traded at a discount to NAV of up to 20%. By applying this discount, we arrive at PPHE's value per share of £23.18.

Sensitivities

- Cyclical business and heavily dependent on the global economy.
- External events such as terrorism, mitigated by recovery potential and guest mix.
- Influence of controlling shareholders, albeit recently lowered. Related-party transactions, mitigated by strict governance, with a record of success.
- Largely fixed cost base, tempered by effective yield management and implementation of as flexible a business model as possible.
- Financing risk, mitigated by loan-to-value policy/banks' support and successful refinancing.
- Foreign exchange exposure.
- Dependence on brand perception.
- Reliance on relationship with Radisson Hotel Group but termination very unlikely.
- Tightening labour markets partly mitigated by focus on award-winning learning and development initiatives, apprenticeships and in-sourcing.

Financials

Our estimated 2019 net debt of £508m is well within long-term bank facilities of about £700m, which mature substantially in 2026–28. With regard to expansion, PPHE has a well-established policy and track record of borrowing within a 65% loan-to-value requirement of its banks. Management is confident it can leverage on its assets for future development projects.

The company seeks to reduce the seasonality of its business by optimising its guest mix (particularly business against leisure) and its impact on profit by securing as flexible a cost base as possible (seasonal employees in Croatia may be employed in year-round operations in Germany and Hungary). It also enjoys substantial recurrent revenue through agreements with business travel agencies and large corporates for discounted room rates.

Company description: Developer, owner and operator of hotels

Gateway focus

PPHE has developed a collection of popular (typical Booking.com guest score of 8.5 out of 10), full-service, four-star, deluxe and boutique hotels with a good geographic spread and guest mix (c 50% business customers). With a focus on European cities (gateway and regional), there is particular representation in the important lodging markets of London, Amsterdam and Berlin, where the hotels are predominantly owned and operated under the Park Plaza brand. The repositioning of Riverbank close to existing company properties, headed by flagship Westminster Bridge, one of Europe's leading conference hotels, enhances a unique ability to offer over 1,000 rooms in one area for events in central London and most advantageously on the vibrant South Bank. In turn, in Amsterdam its landmark Victoria has newly completed transformative investment. Consolidation of resort activities (hotels, self-catering apartment complexes and campsites) in Croatia in 2017 has brought material exposure to a tourism market with strong fundamentals as well as reshaping in terms of business and seasonality.

Exhibit 1: Portfolio (wholly owned and Park Plaza unless stated otherwise)

UK	Booking.com guest rating scores	Rooms
London:	(out of 10)	
■ Westminster Bridge*	8.7	1,019
■ Riverbank	8.6	555
■ Plaza on the River	8.7	90
■ Waterloo (199-year finance lease)	8.7	494
■ Victoria	8.6	299
■ Holmes (unbranded premium boutique) (set to relaunch in May 2019)	8.3	118
■ Park Royal	8.7	212
■ County Hall (managed; 11% owned)	8.4	399
Total		**3,186**
Leeds	8.3	187
Nottingham	8.5	178
Cardiff (franchised)	8.8	129
Total		**3,681**
Netherlands		
Amsterdam:		
■ Victoria	8.5	298
■ art'otel	8.9	107
■ Vondelpark (set to relaunch following investment in H119)	7.9	102
■ Airport	7.9	342
Total		**849**
Utrecht (set to relaunch following investment in H119)	7.8	120
Eindhoven	8.5	104
Total		**1,073**
Germany and Hungary (52% owned)		
Berlin:		
■ Wallstreet Mitte (operating lease)	8.7	167
■ art'otel kudamm	8.2	152
■ art'otel mitte (joint venture)	8.9	109
■ Kudamm (joint venture)	8.3	133
Total		**561**
Nuremberg	8.9	177
Cologne art'otel	8.5	218
Budapest art'otel (operating lease)	8.8	165
Trier (franchised)	8.9	150
Total		**1,271**
Croatia (52% owned)		
Istria (Pula and Medulin):		
■ 13 hotels and self-catering apartment complexes of which four Park Plaza (1,368 rooms; average Booking.com score 8.8)		**2,775**
Total		**8,800**
Croatia (52% owned)		**Pitches and mobile homes**
Istria (Pula and Medulin):		
■ Eight campsites including Arena One 99 Glamping (199 tents)		**5,903**

Source: PPHE Hotel Group. Note: *Assuming continued control over units sold under 999 year leases.

Flexible model

The breadth of ownership interests and contractual arrangements in PPHE's hotels allows the company to maximise opportunities from the varied markets in which it operates and may enter. As shown in Exhibit 1, ownership (including long-term finance leases) accounts for about 90% of room stock and almost all UK and Netherlands operations. It also applies to the company's largest current development project, art'otel london hoxton. Although it is capital intensive, ownership offers scope for asset appreciation, especially in key gateway cities in Europe, and management has a strong record in real estate development and a self-professed entrepreneurial spirit. Operating leases (15 to 25 years) cover only two properties in Germany and Hungary (art'otel budapest was recently renewed for 20 years), while the sole management contract (County Hall, London) runs until 2033. Franchise arrangements account for barely 3% of overall room stock (two hotels);

revenue comes from brand royalty or licensing fees (c 3.5% of hotel revenues), one-off fees on opening under the company's brands and ancillary services.

Strong branding

Apart from several Croatian resort properties that use the locally known Arena brand, all hotels (except for the newly-repositioned Holmes) are branded Park Plaza (c 70% of rooms) or art'otel. While distinct in terms of target customers and property size (the former targets the business as well as leisure market and favours larger properties, ie typically 200+ rooms), both brands address the growing 'affordable luxury' segment (high quality at attractive rates). Outside Europe, the Middle East and Africa, where the company holds an exclusive right to use the brand in perpetuity under its agreement with Radisson Hotel Group, there are 18 Park Plaza properties (2,100 rooms) in operation and under development in Asia Pacific.

art'otel is an established 'lifestyle' brand, targeting those with an interest in art and culture by aspiring to be represented at key cultural hot-spots. In keeping with a new social environment and desire for differentiation, such 'lifestyle' hotels are increasingly seen as an attractive and strategic market by most hotel groups. For example, AccorHotels has delivered on its 2016 optimism that the segment may double within five years by developing the most comprehensive branded portfolio including 10% of global pipeline. At art'otel, contemporary architectural styling is married with art-inspired interiors (each property is dedicated to a particular artist, eg Warhol at berlin kudamm). Amsterdam, only the second development since PPHE's acquisition of the brand in 2007, opened in 2013 to wide acclaim, with sites in London (Hoxton and Battersea Power Station) and New York due to open in 2022/23. While ownership of the brand is subject to a perpetual licence in favour of the brand founder elsewhere in Europe (France, Germany, Italy, Spain, Austria and Switzerland), there is reassurance that any such hotel will be managed by the group.

Bumper distribution

Inclusion in the reservation and distribution systems of Radisson Hotel Group, one of the largest hospitality and travel companies in the world, continues to be very positive for PPHE and is its largest hidden asset. As well as customer referrals, it provides reliance on a far larger and more sophisticated system than potentially in-house, ie in operation and under development over 220,000 rooms (1,400 hotels) in 115 countries and powerful brands, notably Radisson Blu. There should also be opportunity from Radisson Hotel Group's recent acquisition by Jin Jiang International, a leading Chinese hospitality and travel group, such as direct access to the world's largest and fast-growing outbound travel market and to Jin Jiang's loyalty programme of 100m members. Together, Jin Jiang and Radisson Hotel Group form the second largest hotel group worldwide.

There is substantial benefit from access to the alliance's market-leading loyalty programmes for guests, business travel agents, meeting planners and corporates. With over 20m members, guest loyalty programme Radisson Rewards (rebranded from Club Carlson in March 2018) was an important part of previous owner Carlson's strategic commitment to help hotels increase revenue. PPHE confirms that increased loyalty apart, room rates from members tend to be higher than from non-members.

E-commerce initiatives, boosted by this relationship, include email marketing, online advertising and building affiliate networks. The company's social media fan base, which is well ahead of that of other hotel brands of similar size, continues to be actively managed.

Development strategy

PPHE is notably upfront about intended value creation. Key to its business model is asset ownership as it affords control over investment, quality and realisation of value, driving growth in

EPRA NAV per share by 18% CAGR since 2010, based on Savills valuation. Meanwhile since 2014 there has been double-digit CAGR gain in revenue and EBITDA. Typically land and buildings with significant potential are targeted for purchase, then redeveloped and in due course refinanced to release capital for future growth. A notable example of this was the 2017 sale and finance leaseback of Waterloo, that year's largest London hotel opening, which endorsed PPHE as developer and asset owner via an effective c 100% return in just four years, complemented by agreeing a long-term finance lease on attractive terms (low yield of 3.5%). This followed acquisition in 2013 of a redundant office building (Hercules House), which was developed by 2017 into a 494 room hotel. The total cost of the project was £125m (c £250,000 per key). The sale and leaseback saw the freehold of the property sold for £161.5m and the agreement of a 199-year lease at an initial rent of £5.6m pa. Independent valuation in 2018 of the remaining leasehold interest at £84m thereby resulted in the creation of £120m value (c £3 per share).

PPHE's confirmed three-year openings pipeline (Exhibit 2) is headed by a project of potentially even greater stature (budgeted cost £180m). In Hoxton, the west end of Shoreditch, the company looks to emulate its success in South Bank regeneration in an area of rapid economic growth, particularly in the tech, media, fashion and other creative industries. Indeed its 'edgy' reputation ('a haunt for artists, oddballs, inventors of a new paradigm of urban experience,' per Condé Nast Traveller) suggests a venue highly suited to the UK introduction of the lifestyle art'otel concept. Development starts now on an innovative cylindrical 27-storey (32,000 sqm) mixed-use scheme. Newly improved planning consent covers a hotel (343 rooms/suites), five floors of offices and five floors for mixed use including a gym, an art gallery and event space. Opening is due in 2023.

Exhibit 2: Confirmed openings pipeline

	Opening	Rooms	Cost (£m)
Owned:			
London art'otel hoxton*	2023	343	180
Belgrade 88 rooms	Late 2019**	88	5
Managed:			
London art'otel battersea power station	2022	160	-
New York* art'otel	2022	98	13***

Source: PPHE Hotel Group. Notes: *Mixed-use scheme. **Subject to completion. ***Pre-construction commitment to joint venture.

PPHE also has a clear aim to use its reputed brands to become a leading hotel operator in upscale and lifestyle hotel segments. Hoxton should be complemented by planned art'otel openings at similarly high-profile urban redevelopments, namely Battersea Power Station in London (160 rooms) and Hudson Yards in New York (98 rooms). At the former, restoration of the Power Station building is expected to complete late next year. Of one million square feet of commercial space available in the building, over half has been let to Apple for their new London Campus and to No18, a business members club owned by IWG. The first phase of the wider redevelopment on the 42-acre site, Circus West Village, is open with independent restaurants, shops, bars and leisure facilities, while a new zone one London Underground station on the Northern Line will provide good transport links to the rest of the capital. The year 2022 should also see the opening of art'otel in West Chelsea on Manhattan's West Side, next to Hudson Yards, the largest private real estate development in the US (over 18m square feet of commercial and residential space). As with Hoxton, the brand is in keeping with a district reputed for art, fashion and innovation and the scheme is mixed-use (55 residential condominiums).

In line with its model of broad contractual interests, in contrast to Hoxton, both art'otels will be management contracts with capital commitment by PPHE limited to $18m pre-construction joint venture costs in the case of Hudson Yards.

The proposed move into Serbia is in line with Arena's longstanding ambition to develop in central and south-eastern Europe. While it is not a development project, 88 Rooms in Belgrade is attractive in terms of yield both as an already successful hotel (Booking.com guest score 9.1) and its potential in a growth market like that of Croatia.

However, this is only the confirmed openings pipeline. Further significant deals are to be expected as the company is explicit about its active search for new assets in both key cities and resorts; in 2018 alone, some 145 opportunities were identified. It is equally forthright about its reluctance to pay up, specifying that proposals were submitted for barely 10%. Consolidation in London and Amsterdam is targeted but deterred by intense competition and hence unreasonable prices, while interest is admitted in new locations such as Porto, Paris and Lisbon.

Financial flexibility is evident in c £150m at December 2018 designated by the company as excess cash to fund further growth. Also, management does not regard debt as a restriction to growth as long as it can be serviced and is secured judiciously against likely appreciating assets; it has a well-established policy and track record of borrowing within a 50% to 65% loan-to-value requirement of its banks, eg 2016 refinancing of the bulk of its owned estate in London and the Netherlands. Impressively, growth since its IPO in 2007 has been funded without raising equity.

Development is also substantially by investment in existing assets. In addition to renovations there is a strong confirmed pipeline of projects that PPHE calls repositionings (Exhibit 3), namely major investment programmes involving reconfiguration and aiming for a step-change in performance:

Exhibit 3: Confirmed pipeline of repositionings

	Completion	Rooms	Cost (£m)
London Holmes	May 2019	118	9
Amsterdam Park Plaza Vondelpark	H219	102	8
Utrecht Park Plaza	H219	120	5
Berlin art'otel kudamm	2020	152	5
Croatia:			
Kažela Campsite	Summer 2019	1,412 pitches*	14
Verudela Beach Resort	2020	166	8
Brioni	2022**	228	22

Source: PPHE Hotel Group. Notes: *Addition of 164 mobile homes. **Planned closure in late 2020 and 2021.

2018 was notable for completion of more sizeable multi-year repositionings at Riverbank (£54m cost, including an additional 185 rooms) and Victoria Amsterdam (£20m) with targeted EBITDA growth of 40% and 25% respectively. Less expensive (£8m) but potentially with even sharper returns (aiming for EBITDA to more than double), an all-glamping offer, Arena One 99, was introduced to the former Pomer campsite in Croatia.

Management

PPHE's senior management (see below) is based at the company's head offices in Amsterdam and London and backed by highly experienced local management.

- **Boris Ivesha** has been **president and CEO** since 1991. He has over 50 years' experience in the hotel industry, including at landmark properties Royal Horseguards Hotel, London and Carlton Hotel, Tel Aviv, where he was respectively general manager and managing director. In 1994 he brought the Park Plaza Hotels & Resorts brand to the company in partnership with chairman Eli Papouchado and the Red Sea Group, an international real estate business.
- **CFO Daniel Kos** joined PPHE in 2011 after senior positions within audit and finance, including 11 years at Mazars, the international accountancy and advisory firm. He became CFO in 2018.
- **Eli Papouchado** has been **chairman** since the company's formation in 1989 and is founder and major shareholder of Red Sea Group. Regarded as a pioneer in Israel's hotel industry, he has been actively involved in the development, financing, acquisition and management of

PPHE's leading hotels and the development of shopping malls and large residential projects in the US, Eastern Europe and the Middle East.

Sensitivities

- The hotel industry is highly cyclical and dependent on the global economy. PPHE competes for a share of disposable consumer income, which may be eroded by economic downturn.
- Geopolitical events and natural disasters can have a significant impact on profitability. The company maintains a diverse guest nationality mix to minimise this risk. Consolidation of Croatian interests has brought a reshaping of business and seasonality.
- Although the chairman and chief executive have material influence over the company (c 43% holding), a strategic goal of broadening the investor base has been effected by the move to a stock exchange Premium Listing and enhanced free float of over 50%, which qualifies for inclusion in the FTSE UK series of indices.
- PPHE is significantly reliant on its relationship with Radisson Hotel Group. However, termination of its territorial licence by Radisson Hotel Group is possible only in very limited circumstances and in any case the relationship remains strong.
- Much of the company's cost base is fixed. This risk can be mitigated by effective yield management and the development of as flexible a business model as possible.
- An active development programme may tie up balance sheet capacity and lead to asset write-downs if they fail. Growth depends on the availability of suitable sites and access to funding.
- There is exchange rate exposure. There is also a debt financing and interest rate risk. A guaranteed yield to owners of units at Westminster Bridge may not be covered by net income from those units, although its proven trading strength suggests this is unlikely.
- Tightening labour markets partly mitigated by focus on award-winning learning and development initiatives, apprenticeships and in-sourcing.

Valuation: UK/Netherlands portfolio at attractive yield

PPHE's current share price is markedly below its last reported EPRA NAV per share of £24.57. We have thus analysed whether this discount to NAV is justified by the location of PPHE's assets and the fact that the company is not a pure-play property investor as it manages hotels and operates some under operating lease agreements. From a valuation perspective, we believe it is instructive to examine the average capitalisation yield on PPHE's property portfolio implied by the current share price. This is an important parameter for investors as it measures the attractiveness of PPHE's current market valuation from the perspective of hotel earnings afforded by the company. Our first step is to estimate hotel net operating income (NOI), based on reported 2018 group EBITDAR excluding earnings from the management and central services division. We adjust as follows:

- add back the earnings lost due to renovations and subsequent ramp up in 2018 (eg with regard to Sherlock Holmes and several other properties in the UK, Netherlands and Germany);
- subtract earnings attributable to the 48% minority stake in Arena;
- eliminate EBITDA of hotels under operating leases (although we estimate not material) but note the minor benefit from termination of the loss-making lease for art'otel dresden from July 2018;
- apply a furniture, fixture and equipment (FF&E) reserve in line with industry standards (and PPHE's assumptions) at 4% of hotel revenues; and

- subtract financial lease expenses (the company leases certain land and properties in London under agreements longer than 100 years) as well as expenses related to the income units in Westminster Bridge, arriving at adjusted NOI of c £66m (see Exhibit 4).

Exhibit 4: PPHE's FY18 NOI calculations (£m unless otherwise stated)

EBITDAR by region 2018	
UK	66.8
Netherlands	14.2
Germany and Hungary	9.0
Croatia	19.7
Group EBITDAR 2018 (ex management and central services)	**109.7**
Adjustments for:	
Refurbishments / ramp up	2.2
Assets under operating lease	0.1
Arena minorities	(14.1)
Adjusted 2018 group EBITDAR	**97.9**
FF&E reserve	(10.6)
as % of total adjusted 2018 group revenue	4%
Financial lease expenses	(8.7)
Expenses related to units in Westminster Bridge	(12.3)
Share in result of joint ventures	0.1
Net operating income	**66.4**

Source: Edison Investment Research, PPHE accounts

Our next step is to divide NOI by the implied value of PPHE's hotel properties based on the current share price. To arrive at the latter, we take the market cap and add the last-reported net debt figure (at December 2018) after excluding the proportion attributable to Arena minority shareholders. We have also excluded PPHE's non-real estate assets and liabilities (net working capital items in particular) and the value of the Hoxton project (£82.5m according to the recent valuation by Savills).

To conclude, we have estimated the value of PPHE's hotel management business to isolate the value of its hotel properties. These activities are represented by the management and central services division, which generated £42m revenue (before eliminations) and £10.3m EBITDA in 2018. We have valued the business using a DCF method based on a WACC (calculated separately for each year) of 7.3–7.8% and a terminal growth rate of 1.5%, arriving at a fair value of £161m. We have allowed for art'otel hoxton but not for the two new art'otel management contracts. This clearly illustrates that the management business represents incremental value on top of the NAV of PPHE's properties.

As a sense check to our DCF valuation of management and central services, we have conducted a comparative valuation based on global peers with relatively asset-light models, including Wyndham Hotels & Resorts, IHG, AccorHotels, Marriott and Hilton. Our estimated average EV/EBITDAR ratio adjusted for capitalised operating lease liabilities for this peer group is 14.4x for 2018 (used in the absence of available EBITDAR consensus). When applying this multiple to PPHE's management and central services division's 2018 EBITDA (adjusted for refurbishments and asset ramp up), we arrive at a fair value of £152m. We acknowledge that our selected peers possess a much stronger brand and market presence than PPHE. However, as our DCF-derived fair value also captures growth prospects associated with the new management contracts, we include the average for both methods in our yield calculations at £156.2m (360p per PPHE share, see Exhibit 5).

Exhibit 5: PPHE's implied real estate value calculations (£m unless otherwise stated)	
Implied real estate value calculations	
PPHE share price (p)	1,690
Diluted number of shares (m)	42.86
Market cap	**724.3**
Net debt (adjusted for minorities) at December 2018	472.1
Adjustments for:	
Hoxton development project	(82.5)
Net non-real estate (assets)/liabilities	1.4
Management and central services valuation	(156.2)
Implied real estate value	**951.7**
Implied capitalisation yield (%)	**7.0**

Source: Edison Investment Research, PPHE accounts

Therefore we obtain an implied capitalisation yield of 7.0%. We estimate the prevailing weighted average prime capitalisation yield in the property markets where the company operates is c 5% and thus visibly below PPHE's implied capitalisation yield, suggesting the market is not fully reflecting the value of the company's properties.

Given the lack of European listed hotel REITs, we also compare PPHE's implied yield to the average levels for US hotel REITs focused on upscale and upper scale segments. Our calculations (summarised in Exhibit 6) indicate these peers trade at an average implied capitalisation yield of 8.0%, which is slightly higher than our estimate for PPHE.

Exhibit 6: Implied capitalisation yield for selected US hotel REITs

	Share price (US$)	NOI * (US$000s)	Implied real estate value** (US$000s)	Implied cap yield
Ashford Hospitality Trust	4.9	408,811	4,728,686	8.6%
Apple Hospitality REIT	16.6	423,609	5,112,279	8.3%
Condor Hospitality Trust	9.1	25,036	248,284	10.1%
Chesapeake Lodging Trust	28.4	166,705	2,422,534	6.9%
DiamondRock Hospitality Company	10.9	245,490	3,245,380	7.6%
Hersha Hospitality Trust	17.3	136,789	2,119,715	6.5%
Summit Hotel Properties	11.6	183,250	2,364,725	7.7%
RLJ Lodging Trust	17.9	487,960	5,399,332	9.0%
Sunstone Hotel Investors	14.6	293,174	3,880,148	7.6%
Average	-	-	-	**8.0%**

Source: Company filings, Edison Investment Research. Note: *Estimated based on FY18 hotel EBITDA and an FF&E reserved calculated as 4% of FY18 hotel revenue. **Based on market capitalisation at 4 April 2019 and net debt, preferred equity and net working capital at December 2018.

However, we note there are considerable differences in market yields between London (about two-thirds of PPHE's portfolio value at end 2018) and major central business district locations in the US. The average national-level capitalisation rate in full service segments stood at 7.68% in H218, according to a recent capitalisation rate survey conducted by CBRE. This compares with a prime yield of 4.05% for London according to GVA's UK Hotel Market Outlook in autumn 2018.

An alternative way to look at PPHE's valuation is to examine its return on EPRA NAV of £24.57 per share as implied by the company's EPRA EPS, which was just 4.6% at end 2018. However, we note that PPHE's EPRA NAV includes the Hoxton project, which has yet to generate profit. Moreover, PPHE has a high cash balance while looking for projects for acquisition. The company estimates that after adjusting for these, the return on EPRA NAV is 5.6%. We also note that PPHE's 2018 figure was affected by renovations. Based on our EPRA EPS forecasts and assuming a flat EPRA NAV, the return increases to 6.0% in 2020 and 6.7% in 2021. Indeed, since the current share price is below EPRA NAV per share, we have also calculated the implied return on the market cap (based on the company's adjustments for excess cash and Hoxton project), which stands at 9.1% based on 2018 earnings. This confirms our conclusions from implied capitalisation yield analysis.

Based on the above calculations as well as Savills/Zagreb Nekretnine's EPRA NAV estimate, we may conduct a sum-of-the-parts valuation (see Exhibit 7). After adjusting for net debt, minorities and non-real estate assets, we obtain a value of 2,807p per share. Importantly, these calculations are based on the assumption that the market is applying no discount to the NAV valuation of the properties. However, we acknowledge that US hotel REITs are trading now at a discount to NAV of around 5–20%. Therefore, if we were conservatively to apply a 20% discount to PPHE's net property value, we would arrive at 2,318p, which still provides material upside to the share price.

Exhibit 7: PPHE's SOTP valuation (£m, unless otherwise stated)

Savills/Zagreb Nekretnine's valuation (at end 2018)	1,670.1
Net debt adjustment	(479.6)
Minorities adjustment	(142.2)
Management and central services division value (Edison estimate)	156.2
Net non-real estate assets/(liabilities)	(1.4)
PPHE valuation	1,203.2
Number of shares	42.86
PPHE value per share (£) – assuming no discount	**28.07**
PPHE value per share (£) – @ 20% discount	**23.18**

Source: Company accounts, Savills, Zagreb Nekretnine, Edison Investment Research

Finally, we have applied a propco-opco method to analyse PPHE's value by conducting a hypothetical split into a pure property investor (propco) and an entity operating the hotels under a lease agreement (opco). We have assumed the propco value is in line with PPHE's last reported EPRA NAV at £24.57, while the opco value was derived from a DCF model on the following assumptions: 1) average rental rate across the property portfolio of 5.5%; 2) asset value at £1,670.1m (in line with Savills/Zagreb Nekretnine's last valuation); 3) no capex at the opco level; 4) no debt at the opco level, in line with the current status (all debt at property level); 5) WACC equal to cost of equity at 6.6–7.2%; and 6) a terminal growth rate of 1.5%. Therefore we obtain a positive opco value of £1.86 per share, which with the property value translates into a total valuation of £26.43 per share. We believe our rental rate assumption is prudent, with recent fixed income investment deals in the UK property market completed at a yield of 3.3–5.0%. For our sensitivity analysis, we have estimated the rental rate translating into the opco value at null is c 5.8%.

In summary, our implied capitalisation yield analysis and the SOTP valuation indicate that PPHE's discount to EPRA NAV is not justified by its management business (which we believe to be a clear value contributor), while activities on operating leases are negligible in terms of valuation. This is confirmed by our propco-opco analysis, which suggests the valuation of a standalone hotel operator (which does not own the properties but uses under operating leases) would still be positive.

We understand that PPHE's EPRA NAV (£24.57, which forms the basis of our valuation analysis) estimated by Savills and Zagreb Nekretnine is based on future cash flows generated by the respective properties and thus captures the prospective increase in hotel operating income following the recent refurbishments. As a result, if we exclude the impact of the Hoxton project ramp up and acquisitions of new projects, PPHE's EPRA NAV should remain broadly stable or grow at a low rate (implied purely by the time value of money) over the next few years. Having said that, we believe that the market is not fully capturing the existing value of PPHE's properties (as discussed in our valuation analysis), which implies solid upside to the current share price.

Asset quality review

We have further decided to examine if PPHE's property portfolio may be considered 'prime' in terms of location and asset quality. This would confirm our statement that its current implied capitalisation yield of 7.2% seems high relative to prevailing prime yields in the market. This in turn would suggest that PPHE's property value implied by the current share price is below its actual market value as estimated by Savills and Zagreb Nekretnine.

The company's upscale portfolio consists of eight hotels in London (Plaza on the River and Riverbank treated separately despite the same address), of which two (Waterloo and Park Royal) are recent openings (2017) and one (Riverbank) has been substantially extended and repositioned. In addition, the repositioning of Sherlock Holmes should complete in May 2019. While Park Royal is more characteristic of a busy UK regional hotel than a central site, it is especially well located next to the largest industrial and business estate in the UK (2,000+ businesses) and close to Wembley Stadium, SSE Arena and Westfield London, the biggest shopping centre in Europe. Exposure to UK regional UK (Leeds and Nottingham) is modest (c 4% of group hotel rooms). In the Netherlands PPHE owns four hotels in Amsterdam, including landmark Victoria, newly repositioned, and Vondelpark, transformative refurbishment almost complete. Repositioning is also underway at Utrecht. Significant ownership interests in Germany include three hotels in Berlin (one earmarked for major renovation), Nuremberg (2016) and Cologne.

By contrast, operations in Croatia are in leading tourist region, Istria. Properties are a mix of hotels, holiday apartment complexes and campsites and trading is highly seasonal. Hotel classification varies from upscale Histria to budget-friendly Brioni (heritage site, to reposition by 2022), while accelerating development of campsites is highlighted by the introduction of glamping.

As most properties are in prime locations and well invested, we believe PPHE constitutes a good entry point for exposure to the London and Netherlands property market at an attractive yield level.

Financials

Exhibit 8: Analysis of revenue and profit

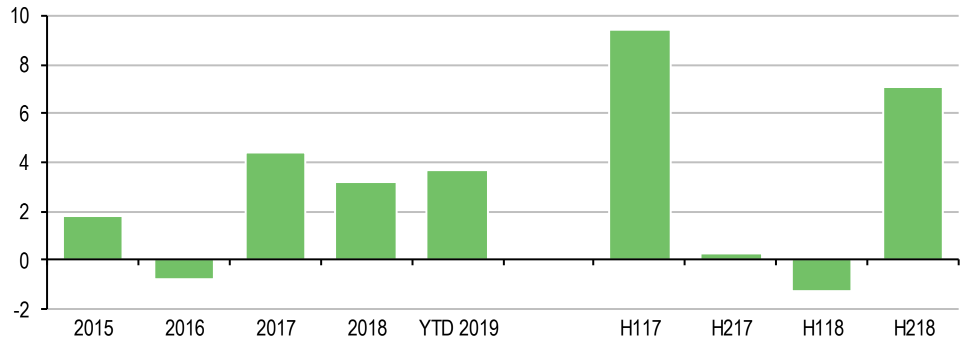
Y/E December (£m)	H117	H217	FY17	H118	H218	FY18	2019e	2020e
Revenue								
London								
RevPAR	£132	£152	£142	£130	£159	£145	£146	£148
Change	+10%	Flat	+4%	-1%	+5%	+2%	+1%	+2%
Available rooms	2 020	2 020*	2 020*	2 040*	2 050*	2 045*	2 050*	2 080
Room revenue	48.2	56.5	104.7	48.0	60.0	108.0	109.5	112.5
Non-room revenue	22.5	22.8	45.3	22.2	23.0	45.2	46.5	47.5
Existing revenue	**70.7**	**79.3**	**150.0**	**70.2**	**83.0**	**153.2**	**156.0**	**160.0**
Waterloo + Park Royal**	9.8	14.2	24.0	14.0	15.6	29.6	31.5	32.3
Total London revenue	**80.5**	**93.5**	**174.0**	**84.2**	**98.6**	**182.8**	**187.5**	**192.3**
Leeds and Nottingham	5.1	6.7	11.8	5.4	6.9	12.3	12.5	12.7
UK	**85.6**	**100.2**	**185.8**	**89.6**	**105.5**	**195.1**	**200.0**	**205.0**
Netherlands (€m)	28.9	25.2	54.1	28.2	27.8	56.0	61.6	68.4
Exchange rate	1.16	1.12	1.14	1.14	1.12	1.13	1.13	1.13
Netherlands	**24.9**	**22.4**	**47.3**	**24.8**	**24.8**	**49.6**	**54.5**	**60.5**
Croatia (HRKm)	125.2	354.6	479.8	137.3	366.5	503.8	525.0	550.0
Exchange rate	8.64	8.40	8.52	8.42	8.35	8.37	8.60	8.60
Croatia**	**14.5**	**41.8**	**56.3**	**16.3**	**43.9**	**60.2**	**61.0**	**64.0**
Germany and Hungary***	**14.4**	**16.3**	**30.7**	**15.9**	**15.5**	**31.4**	**28.5**	**31.0**
Owned & leased hotels	**139.4**	**180.7**	**320.1**	**146.6**	**189.7**	**336.3**	**344.0**	**360.5**
Management and Central Services	2.4	2.6	5.0	2.2	3.0	5.2	6.0	6.5
TOTAL	**141.8**	**183.3**	**325.1**	**148.8**	**192.7**	**341.5**	**350.0**	**367.0**
EBITDA								
London								
Existing	**23.4**	**29.1**	**52.5**	**22.5**	**30.0**	**52.5**	**51.6**	**52.5**
Margin (%)	**33**	**36**	**35**	**32**	**36**	**34**	**33**	**33**
Waterloo + Park Royal**	1.8	4.2	6.0	4.5	5.9	10.4	11.3	11.6
Total London EBITDA	**25.2**	**33.3**	**58.5**	**27.0**	**35.9**	**62.9**	**62.9**	**63.8**
Leeds and Nottingham	0.8	1.2	2.0	0.9	1.2	2.1	2.1	2.2
UK	**26.0**	**34.5**	**60.5**	**27.9**	**37.1**	**65.0**	**65.0**	**66.0**
Netherlands (€m)	8.8	6.4	15.2	8.1	7.8	15.9	18.6	20.3
Exchange rate	1.16	1.12	1.14	1.14	1.12	1.13	1.13	1.13
Netherlands	**7.5**	**5.8**	**13.3**	**7.1**	**7.0**	**14.1**	**16.5**	**18.0**
Croatia (HRKm)	Neg.	159.1	159.1	0.8	154.5	155.3	172.0	181.5
Exchange rate	8.64	8.40	8.52	8.42	8.32	8.37	8.60	8.60
Croatia**	**Neg.**	**18.7**	**18.7**	**0.1**	**18.5**	**18.6**	**20.0**	**21.0**
Germany and Hungary**	**1.7**	**2.6**	**4.3**	**2.1**	**3.1**	**5.2**	**5.5**	**5.7**
Owned & leased hotels	**35.2**	**61.6**	**96.8**	**37.2**	**65.7**	**102.9**	**107.0**	**111.0**
Management and Central Services	4.7	5.8	10.5	3.4	6.9	10.3	11.0	11.5
TOTAL	**39.9**	**67.4**	**107.3**	**40.6**	**72.6**	**113.2**	**118.0**	**122.5**

Source: Edison Investment Research. Note: *Phased extension of Riverbank in 2017 and H118 offset by rooms off at Sherlock Holmes (est. 30). **Waterloo (494 rooms) + 4.17 Park Royal (212 rooms). ***Rooms off in Amsterdam (Victoria H217 and H118, Vondelpark H218 and H119) and Utrecht (H218 and H119). ****Excludes campsites. *****8.18 Termination of Dresden lease (174 rooms).

Strong end to 2018

Disclosure of 5% like-for-like RevPAR growth for 2018 suggests c 8% improvement in the final quarter, which is impressive as it was boosted by neither currency nor Croatia (Q4 is its low season). Therefore, in the absence of detailed regional breakdown, we may infer pronounced buoyancy in largest profit source, London (market RevPAR up 10%, per STR – Exhibit 9) as well as a benefit from significantly higher rates at newly repositioned Victoria Amsterdam. We estimate (Exhibit 8) that, allied with a 'solid' Q3, this spurred a broad reversal in H2 of first-half EBITDA shortfalls at core London properties and in Amsterdam. These had been attributed respectively to a demanding comparative (market RevPAR down 1% against recovery-led +10% buoyancy in H117) and renovations (estimated 7% rooms off with associated disruption). The overall rise in second-half EBITDA was driven, as in H1, by maturing Waterloo and Park Royal in their first full year.

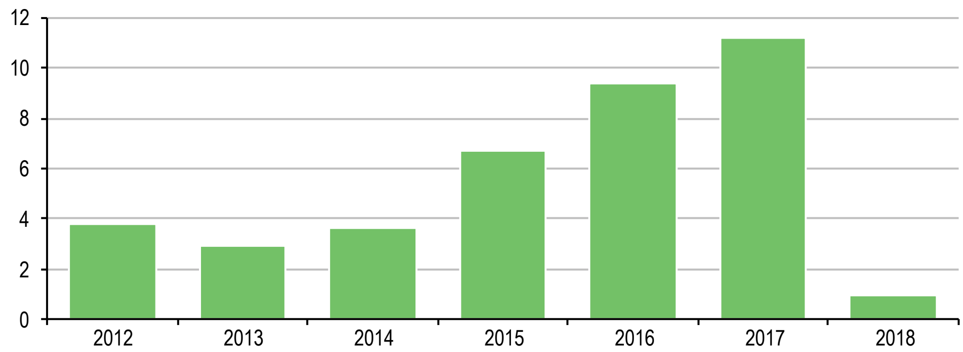
Exhibit 9: Annual and half-yearly % changes in London market RevPAR



Source: STR

Croatia arguably disappointed with a slight dip in H2 profit against our growth expectation but a bumper 2017 summer was a hard act to follow (Exhibit 10) and unhelpful weather (prolonged heatwave in northern Europe) delayed holiday decisions across most European markets but in particular campsite custom, which tends to be last minute. Also the new glamping offer, while well received, opened too late to contribute materially. Encouragingly, the region moved marginally into profit in H1 (usually lossmaking) thanks to a favourable calendar, improved shoulder season trading and investment in artificial football pitches at sports-oriented year-round Belvedere Medulin.

Exhibit 10: Annual % growth in Croatia tourism (peak trading June-Sept foreign tourist nights)



Source: Croatian Bureau of Statistics

On a smaller scale, Germany and Hungary grew H2 EBITDA by c 20% owing to the maturing (both leisure and business) of 2016 opening Nuremberg, weather-led city break demand and termination of its loss-making lease for art'otel dresden.

2019 resilience

As evident in a 'strong' Q1 (like-for-like RevPAR and revenue up 8%), the current period should see continued material payoff from recent transformative investment in London and Amsterdam, offset in part by repositioning Sherlock Holmes London into premium boutique Holmes (reopening late May) and Vondelpark Amsterdam (completion by H2). In particular, while Waterloo and Park Royal are approaching maturity (we still expect near double-digit EBITDA gain), the benefit of a full year of repositioned Riverbank suggests our core London assumption of +1% RevPAR may be cautious. Security and Brexit uncertainty are concerns, but the London hotel market has shown admirable resilience (Q1 RevPAR up almost 4% and 6%, for STR and AccorHotels respectively) and would gain from increased tourism on sterling weakness. PPHE is cheered that its in-sourcing of housekeeping services across the UK is meeting key staffing challenges. Greater measurable worries are room supply, which is above its long-term trend, slower economic growth and rising operating costs. GL, London's largest hotel owner/operator, has newly reiterated that it continues to 'maintain a cautious outlook', while, per PwC, 2019 market RevPAR gain may be marginal.

There is justifiable confidence about the Netherlands in view of both strong fundamentals and investment payoff. The Netherlands Board of Tourism and Conventions forecast c60% rise in national inbound tourism by 2030, the 'hotels freeze' (halt to city-centre development), infrastructure improvements and a possible 'Brexit dividend' have contributed to Amsterdam continuing to be regarded as the most attractive destination in Europe for hotel investment, according to Deloitte. Company-specific positives are a first full year of enhanced Victoria and second-half return of Vondelpark and Utrecht. We look for an 8% increase in RevPAR and for EBITDA to rise by at least double that rate.

Further growth is expected in Croatia, boosted by expansion of operations at Pula airport and the maturing of the £8m Arena One 99 luxury glamping development (awarded best tourist product of 2018 by Istria Tourism Board). There should also be initial returns from repositioning of Kažela campsite with new infrastructure, facilities and premium mobile homes.

The joker in the pack remains expansion, which is being actively examined, even if management is understandably reluctant to pay up, viz. the recent London Grange deal (1,300 rooms) at c £750,000 per key.

More of the same in 2020

Solid core trading and investment payoff should again favour next year, hence our forecast of a further mid single-digit rise in EBITDA. Costs may be expected still to be an issue (not only in London, as well known, but in Croatia, as recently highlighted by Arena). A profit catalyst would be expansion although returns from a development project would necessarily take time to accrue.

Cash flow

The sharp rise in net bank debt in 2018 (£480m up from £408m) reflects in particular buying in its Hoxton joint venture (£35m) and sustained high capex (£67m). However, this is well within long-term bank facilities of c £700m, which have an average term to maturity of almost eight years, interest cover of 4x and average cost of 3%. Acquisition apart, we envisage only a small increase in current-year debt thanks to similarly high capex and pre-construction costs for art'otel new york (£14m). As discussed, with regard to expansion, PPHE has a well-established policy and track record of borrowing within a 65% loan-to-value requirement of its banks. Management is confident it can leverage on its assets by opening similar facilities for future projects.

Exhibit 11: EPRA earnings adjustment

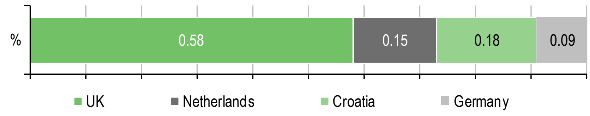
Y/E December (£m)	2017	2018	2019e	2020e
Attributable FRS3	24.3	38.1	29.3	33.0
Adding back:				
Depreciation	34.3	35.9	38.0	38.0
Excluding minorities	(4.6)	(6.1)	(8.1)	(8.1)
Charging:				
Maintenance capex	(13.0)	(13.6)	(14.0)	(14.7)
Excluding minorities	2.5	2.9	3.0	3.1
Exceptionals	0.4	(8.7)	-	-
Attributable EPRA	43.9	48.5	48.2	51.5
Average number of shares (basic)	42.2	42.3	42.3	42.3
EPRA EPS (p)	104	115	114	122

Source: Edison Investment Research

Exhibit 12: Financial summary

	£000s	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		325,100	341,500	350,000	365,000
EBITDA		107,300	113,200	118,000	122,500
Operating Profit (before amort and except)		75,400	79,800	82,500	87,000
Intangible Amortisation		(2,400)	(2,500)	(2,500)	(2,500)
Operating Profit		73,000	77,300	80,000	84,500
Net Interest		(40,600)	(39,700)	(41,100)	(41,100)
Associates		(300)	100	100	100
Exceptionals		(400)	8,700	0	0
Profit Before Tax (norm)		34,500	40,200	41,500	46,000
Profit Before Tax (FRS 3)		31,700	46,400	39,000	43,500
Tax		(1,700)	(2,900)	(3,900)	(4,400)
Profit After Tax (norm)		32,800	37,300	37,600	41,600
Profit After Tax (FRS 3)		30,000	43,500	35,100	39,100
Average Number of Shares Outstanding (m)		42.2	42.3	42.3	42.3
EPS - normalised (p)		64.2	77.5	74.5	83.5
EPS - normalised fully diluted (p)		64.2	77.5	74.5	83.5
EPS - (IFRS) (p)		57.6	90.1	69.3	78.0
Dividend per share (p)		24.0	35.0	40.0	45.0
EBITDA Margin (%)		33.0	33.1	33.7	33.6
Operating Margin (before GW and except.) (%)		23.2	23.4	23.6	23.8
BALANCE SHEET					
Fixed Assets		1,220,200	1,316,600	1,383,000	1,429,000
Intangible Assets		23,600	21,400	22,000	22,000
Tangible Assets		1,037,200	1,151,600	1,220,000	1,270,000
Income units sold to private investors		121,200	119,200	115,000	112,000
Investments		38,200	24,400	26,000	25,000
Current Assets		319,800	245,600	220,800	209,500
Restricted deposits		25,500	3,700	10,000	10,000
Stocks		2,700	2,500	3,000	3,500
Debtors		13,400	15,300	13,800	14,000
Cash		265,700	212,100	180,000	168,000
Other		12,500	12,000	14,000	14,000
Current Liabilities		(93,100)	(68,900)	(74,000)	(74,500)
Creditors		(60,200)	(53,600)	(54,000)	(54,500)
Deposits from unit holders		0	0	0	0
Short term borrowings		(32,900)	(15,300)	(20,000)	(20,000)
Long Term Liabilities		(1,006,000)	(1,014,800)	(1,008,000)	(1,009,000)
Long term borrowings		(666,900)	(682,000)	(680,000)	(680,000)
Financial liability to unit holders		(131,600)	(129,200)	(128,000)	(126,000)
Other long term liabilities		(207,500)	(203,600)	(200,000)	(203,000)
Net Assets		440,900	478,500	521,800	555,000
CASH FLOW					
Operating Cash Flow		114,000	107,000	118,000	122,500
Net Interest		(43,100)	(41,400)	(42,000)	(41,800)
Tax		(700)	(4,200)	(4,700)	(4,900)
Capex		(107,000)	(67,300)	(70,000)	(70,000)
Acquisitions/disposals		152,400	(34,500)	(14,000)	0
Exchange rate		(9,000)	0	0	0
Dividends		(9,300)	(12,300)	(15,700)	(17,800)
Other		79,500	(18,800)	0	0
Net Cash Flow		176,800	(71,500)	(28,400)	(12,000)
Opening net debt/(cash)		584,900	408,100	479,600	508,000
HP finance leases initiated		0	0	0	0
Other		0	0	0	0
Closing net debt/(cash)		408,100	479,600	508,000	520,000

Source: Company accounts, Edison Investment Research

Contact details	Revenue by geography
Vinoly Tower, 5th floor Claude Debussylaan 14 1082 MD Amsterdam The Netherlands +31 207178600 www.pphe.com	

Management team

President and CEO: Boris Ivesha	Non-executive chairman: Eli Papouchado
Boris Ivesha has been president and CEO since 1991. He has over 50 years' experience in the hotel industry, including at landmark properties Royal Horseguards Hotel, London and Carlton Hotel, Tel Aviv, where he was respectively general manager and managing director. In 1994 he brought the Park Plaza Hotels & Resorts brand to the company in partnership with chairman Eli Papouchado and the Red Sea Group, an international real estate business.	Eli Papouchado has been chairman since the company's formation in 1989 and is founder and major shareholder of Red Sea Group. Regarded as a pioneer in Israel's hotel industry, he has been actively involved in the development, financing, acquisition and management of PPHE's leading hotels and the development of shopping malls and large residential projects in the US, Eastern Europe and the Middle East.
CFO: Daniel Kos	
Daniel Kos joined PPHE in 2011 after senior positions within audit and finance, including 11 years at Mazars, the international accountancy and advisory firm. He became CFO in 2018.	

Principal shareholders	(%)
Eli Papouchado	32.5
Boris Ivesha	11.0
Aroundtown Property Holdings	6.2

Companies named in this report

Wyndham Hotels & Resorts, IHG, AccorHotels, Marriott, Hilton Worldwide, Ashford Hospitality Trust, Apple Hospitality REIT, Condor Hospitality Trust, Chesapeake Lodging Trust, DiamondRock Hospitality Company, Hersha Hospitality Trust, Summit Hotel Properties, RLJ Lodging Trust and Sunstone Hotel Investors.

EDISON

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