3 July 2013

Leisure: Whitbread (WTB): 3100p
W Hotels & Restaurants' Presentation

Whitbread today hosted a teach-in on its Hotels & Restaurants division and our comments are set out below:

- Introduction:
    1. Group confirmed that it is on target to hit its 2018 growth milestones – including 75,000 rooms – 'hub' will help to ensure that this happens by opening up new market
    2. Thereafter, there are 'medium term international growth opportunities'
- The Hotel operation as it now stands:
    1. Group has:
        1. 150 solus units (typically City Centre or Airport), these are larger and average 148 rooms
        2. 375 joint sites with its own restaurant – these average 62 rooms per site
        3. 131 co-located sites with third party restaurants – these average 54 rooms and provide the group with its lowest returns
    2. Evolution has been a feature – rebranded as Premier Inn, superior rooms, dynamic pricing, online sales (now 83% of sales from 54% in 2008/09) & now 'hub'. This will continue with 'sleep, park & fly' and other developments
    3. Deep research is a feature with Whitbread, it made 11,000 phone calls in determining which hotels in the UK were still open & has identified c500 micro-markets
    4. Group offers something for everyone and a 'superior budget product'
    5. Premier Inn is the market leader (p17) but in a still-fragmented market
    6. Around 27% of revenue is corporate; there are no current plans for a loyalty card
- The online market:
    1. Growth here is strong and unstoppable but competitors are also active & new players (review sites etc.) are also competing for customers
    2. Mobile devices drive 32% of weekly traffic – first App was launched in 2011
    3. Provides options to cross-sell and up-sell
- Dynamic pricing:
    1. This has been a 'lever for growth' – five years ago, the model was very basic
    2. Occupancy has been driven towards 80%
- Quality control & Costs:
    1. Group has the largest guest survey in Europe with 861,000 responses per annum
    2. Costs are closely controlled; given group volumes, it 'has to be very good at what it does'
    3. Automated check-in is being trialed; one minute of housekeeping could cost >£1m

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4. The group is introducing a new bed, that will be rolled out to its estate, and a 'new generation room'; the latter will cost c£9,300 to refurbish

- The restaurant offer:
  1. 94% are adjacent to a hotel + 10% of restaurant sales come from hotel guest; breakfast is key
  2. 88% of the estate is freehold and 95% is outside the M25; the restaurants are food-heavy & split between Table, Table; Beefeater + Brewers' Fayre
  3. Quality is key – customers who have a bad experience will not come back for 2yrs + will now tell a lot of their friends online
  4. Restaurants are good in their own right but also support Premier Inn; c25 are standalone, good, restaurants
  5. Forward bookings are a small proportion of revenue
- Premier Inn International:
  1. Asset-light model focuses on 6 fast-growing, emerging markets (in the Middle East, India + South East Asia)
  2. Asset light reflects lack of access to freeholds + also represents a lower-risk approach
  3. Would like 10k rooms in 50 hotels in emerging markets by 2018; competition tends to be fragmented
  4. PI UK provides the platform for international growth; WTB owns its UK hotels + this stands it in good stead with overseas partners
  5. International brands in India now include Premier Inn, Ibis, Country Inns and Holiday Inn Express
  6. In South East Asia, Premier Inns has 5 units in the pipeline, budget major Ibis has 35 units open with 12 in the pipeline
  7. Group's mature units should be delivering >10% ROCE by 2018
  8. Would the group make overseas acquisitions? Perhaps to get an entry point or platform; not necessarily a large purchase
- 'hub' by Premier Inn:
  1. Prices will be c30% lower; it will 'access alternative segments of the market'
  2. Smaller rooms + lower prices will directly target Travelodge customers; smaller buildings can be targeted
  3. Smart TV, book on line, all very modern, no 3rd party distribution – no kitchen area, limited back-of-house
  4. Have located c1,000 rooms already, should have c3,000 by 2018; will have its own website
  5. It may be possible to fill rooms at less than a 30% discount to PI (in which case Return on Investment will be higher)
  6. Sites will be predominantly city-centre
  7. Why the 30pc discount? Group took an 'educated guess' for a half-sized room
  8. Could you open co-branded (hub + PI) sites? Just possibly. Hub rooms could be put above or below prime space (which would be branded Premier Inn)
- Likely developments:
  1. Group 'may test Europe' – it mentioned Germany and the Low Countries
  2. The group will become a little less freehold; currently 69% freehold
     1. Freehold is the preferred option as it allows Group to keep all the upside
     2. But 74% of pipeline is leasehold – due to its weighting to city centres
     3. Freehold will slip to 62%
     4. This will lead to margins slipping a little (on rent paid) but returns on capital will rise
     5. London will be a major area of growth; room rates & REVPAR are double those in the provinces
  3. The group sees the opportunity for 'sustainable long term growth with low levels of cannabalisation', particularly in London – group only has a 3% share in Central London
     1. It says that it is not reliant on an economic recovery
     2. Extensions remain a reliable & low risk source of growth
     3. Growth will be determined by perceived returns on capital

Langcap view: Whitbread commented that 'no material new information on current trading or future financial performance will be disclosed in these presentations' and that the purpose of them was to give the audience more detail on the Whitbread Hotels and Restaurants business and to provide a better understanding of the significant growth opportunities.

The group has nonetheless reassured that its 2018 growth milestones remain attainable and has given some indication as to how this will be achieved. Hub should allow the group to access new markets and Whitbread has once again illustrated that it thinks deeply before it commits shareholders' money to new projects.

As regards valuation, Whitbread is not necessarily a cheap stock. It should earn around 166p in the current year and pay a dividend of perhaps 62.5p. Hence its shares, which fell by 1.6% in line with the market today, trade on a PER of 18.7x and offer a yield of around 2.0%.

Both measures suggest that the shares are fully priced when compared to asset-backed companies such as Marston's and Greene King but Whitbread has overseas potential and investors remain attracted to the higher growth prospects that that may imply.

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