

Company Report: **Huazhu Group (HTHT US)**

Noah Hudson

(852) 2509 5441

公司报告: 华住酒店 (HTHT US)

noah.hudson@gjtas.com.hk

18 September 2019

Expect More Short-Term Downside, Downgrade to "Reduce"

预计短期内下行趋势明显, 降至“减持”

- **Huazhu's 2Q19 core EBITDA decreased 0.4% yoy to RMB898 mn, missing our forecast by 4.9%.** Revenue increased 13.4% yoy to RMB2.9 bn, which was in line with the previous guidance range. For all hotels that had been in operation for at least 18 months (mature hotels), the same-hotel RevPAR decreased 2.1% yoy to RMB202. Net income increased 81.1% yoy to RMB613 mn, benefitting from a RMB149 mn unrealized gain from fair value changes of equity securities in 2Q19 compared to a RMB201 mn loss in 2Q18. Unrealized gains (losses) were mainly related to the Company's investment in Accor (AC PA). Excluding share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities, adjusted net income was RMB495 million, down 11.3% yoy.
- **We lower our 2019-2021 core EBITDA forecasts by 1.3%, 4.0% and 14.3%, respectively.** We forecast 2019-2021 core EBITDA of RMB3.2 bn, RMB3.8 bn and RMB4.6 bn, reflecting growth of -1.5%, 19.9% and 21.4%, respectively. Huazhu gave guided 3Q19 net revenues to increase by 9% to 11% yoy, lower than expected. We expect Huazhu's revenue growth rate to slow down this year as sector growth slows down on soft performance in the macro economy. We forecast 2019-2021 fully diluted earnings per ADR of RMB5.55, RMB5.90 and RMB6.45.
- **We lower our target price from US\$33.00 to US\$32.00 and downgrade our investment rating from "Neutral" to "Reduce".** Long term, we are positive on Huazhu's strategy to expand into the upscale market, but we see downside pressure in the short term. Our new target price is a 17.4% discount to our DCF derived NAV of US\$38.72 and is equivalent to 23.9x forward (next four quarters) EV/Core EBITDA.
- **2019 年 2 季度华住核心 EBITDA 同比降低了 0.4%至人民币 8.98 亿元, 低于我们预期 4.9%。** 收入同比增长 13.4%至人民币 29 亿元, 符合此前指引增长区间。对于所有运营时间在 18 个月以上的酒店 (成熟酒店), 同酒店平均每间可供出租客房收入同比下降 2.1%至人民币 202 元。净利润同比上升 81.1%至人民币 6.13 亿元, 得益于 2019 年第 2 季度股票公允价值变动带来的人民币 1.49 亿元的未实现收益, 这一数据在 2018 年第 2 季度为亏损人民币 2.01 亿元。此项未实现收益 (亏损) 主要与公司在雅高酒店 (AC PA) 的投资有关。除去股份激励费用和来自权益证券投资公允价值变化的未实现收益 (亏损), 调整后净利润为人民币 4.95 亿元, 同比降低 11.3%。
- **我们分别下调 2019 年至 2021 年核心 EBITDA 预测 1.3%、4.0%和 14.3%。** 我们预计 2019 年至 2021 年公司核心 EBITDA 分别为人民币 32 亿元、人民币 38 亿元和人民币 46 亿元, 对应-1.5%、19.9%和 21.4%的增长率。华住对 2019 年第 3 季度净收入同比增长率的指引区间为 9%至 11%, 低于预期。我们预计华住今年的收入增长率将放缓, 主要由于宏观经济环境的疲弱表现使行业增长放缓。我们预计 2019 至 2021 年摊薄后每股美国存托凭证收益将分别达到人民币 5.55 元、5.90 元和 6.45 元。
- **我们将目标价从 33.00 美元下调至 32.00 美元, 并将投资评级从“中性”下调至“减持”。** 虽然我们认同华住进驻高端市场的长期战略, 但短期内存在着下行风险。我们新的目标价相对我们用折现现金流方法得出的每份美国存托凭证估值 (38.72 美元) 有 17.4%的折让, 相当于 23.9 倍预测 (未来 4 个季度) EV/核心 EBITDA。

Rating:

Reduce

Downgraded

评级:

减持 (下调)

6-18m TP 目标价:

US\$32.00

Revised from 原目标价:

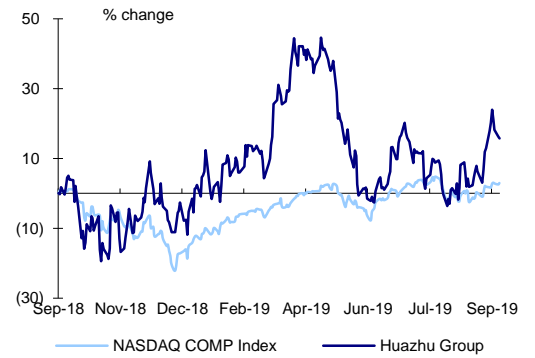
US\$33.00

ADR price ADR 价格:

US\$35.960

Stock performance

股价表现



Change in ADR Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	7.0	10.3	32.8
Rel. % to NASDAQ Index 相对纳指变动 %	3.3	7.4	30.0
Avg. ADR price (US\$) 平均 ADR 价 (美元)	34.3	33.7	33.4

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	Earnings/ADR	Earnings/ADR	PER	BV/ADR	PBR	DP ADR	Yield	ROE
年结	收入	股东净利	每份 ADR 净利	每份 ADR 净利变	市盈率	每份 ADR 净资产	市净率	每份 ADR 股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(Δ %)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2017A	8,229	1,228	4.400	51.1	53.2	22.192	10.5	1.097	0.5	21.2
2018A	10,063	716	2.540	(42.3)	97.4	21.917	11.3	0.920	0.4	11.6
2019F	11,100	1,725	6.056	138.4	42.7	26.927	9.6	1.514	0.6	24.9
2020F	12,478	2,093	7.279	20.2	35.5	31.537	8.2	3.639	1.4	25.0
2021F	14,109	2,573	8.851	21.6	29.2	33.055	7.8	6.638	2.6	27.6

ADR in issue (m) 总 ADR 数 (m)	294.3	Major shareholder 大股东	Qi Ji 42.7%
Market cap. (US\$ m) 市值 (US\$ m)	10,583.6	Free float (%) 自由流通比率 (%)	43.9
3 month average vol. 3 个月平均成交股数 ('000)	1,240.3	FY19 Net gearing (%) FY19 净负债/股东资金 (%)	56.7
52 Weeks high/low (US\$) 52 周高/低 (US\$)	45.390 / 24.900	FY19 Est. NAV (US\$) FY19 每 ADR 估值 (美元)	38.72

Source: the Company, Guotai Junan International.

2Q19 Results

Huazhu Group's ("Huazhu" or the "Company") 2Q19 net revenue increased 13.4% yoy to RMB2.859 billion, which was in line with the management's previous guidance range of 13% to 15% growth. Net revenue from leased and owned hotels increased 5.3% yoy to RMB2.0 billion, while net revenue from manachised and franchised hotels was RMB803 million, up 30.4% yoy, accounting for 28.1% of the Company's total net revenue.

Table-1: Huazhu Results

(RMB mn, except ADR figures)	2Q18	3Q18	4Q18	1Q19	2Q19	2Q19 (% or ppt.)	
						yoy	qoq
Leased & operated hotels revenue	1,900	2,053	1,942	1,706	2,001	5.3%	17.3%
Manachised & franchised hotels revenue	616	699	703	663	803	30.4%	21.1%
Other revenue	6	16	38	18	55	882.7%	205.6%
Net revenue	2,521	2,768	2,683	2,387	2,859	13.4%	19.8%
L&O hotel operating costs (Ex. pre-open costs)	(1,575)	(1,658)	(1,737)	(1,735)	(1,743)	10.7%	0.5%
% of L&O hotels net revenue	82.9%	80.8%	89.5%	101.7%	87.1%	4.2 ppt	(14.6) ppt
L&O hotels pre-opening costs	(66)	(60)	(54)	(104)	(122)	85.9%	17.3%
SG&A	(275)	(326)	(385)	(290)	(366)	33.2%	26.2%
Other operating income (expenses), net	65	51	85	6	29	(55.5%)	383.3%
Income from operations	671	775	592	264	657	(2.1%)	148.9%
Interest expense, net	(20)	(21)	(38)	(44)	(42)	111.8%	(4.5%)
Other non-operating income, net	195	16	1	65	135	(30.8%)	107.7%
Non-operating gains / (losses), net	(343)	160	(862)	(155)	141	n.a.	n.a.
Tax (expense) / benefit	(164)	(255)	(106)	(31)	(286)	74.8%	822.6%
Non-controlling interest	(1)	(7)	(5)	7	8	n.a.	14.3%
Net income	338	668	(419)	106	613	81.1%	478.3%
Less:							
Share-based compensation expense	(18.6)	(20.4)	(26.7)	(26.0)	(31.0)	66.4%	19.2%
Unrealized fair value gains (losses) on equity securities	(201)	179	(756)	(90)	149	n.a.	n.a.
Adjusted EBITDA	965	1,007	737	528	1,068	10.7%	102.3%
Adjusted net income	558	509	364	222	495	(11.3%)	123.0%
Less:							
Other income (expense), net	195	16	1	65	135	(30.8%)	107.7%
Foreign exchange gain (loss)	(132)	(0)	(42)	(32)	35	n.a.	n.a.
Core net income	494	493	405	189	325	(34.3%)	72.0%
Core EBITDA	902	991	779	495	898	(0.4%)	81.4%
Core EBITDA margin	35.8%	35.8%	29.0%	20.7%	31.4%	(4.4) ppt	10.7 ppt
Earnings per ADR, Basic (RMB)	1.20	2.37	(1.48)	0.37	2.16	80.0%	483.8%
Earnings per ADR, Diluted (RMB)	1.14	2.23	(1.48)	0.36	2.05	79.8%	469.4%
Core earnings per ADR, Basic (RMB)	1.76	1.75	1.43	0.67	1.14	(34.9%)	71.5%
Core earnings per ADR, Diluted (RMB)	1.63	1.62	1.34	0.64	1.07	(34.4%)	65.7%

Source: the Company, Guotai Junan International.

Note: the Company has three kinds of hotel operating models, namely: 1) leased-and-operated hotels ("L&O"); 2) franchised-and-managed hotels ("Manachised"), and; 3) franchised hotels.

Income from operations was RMB657 million, down 2.1% yoy and 6.8% below our last forecast, mainly due to the Company's investment in hotel development teams, upscale hotels and IT capabilities. Selling and marketing expenses excluding share-based compensation expenses (non-GAAP) was equivalent to 3.6% of net revenue, compared to 3.3% for 2Q18. General and administrative expenses excluding share-based compensation expense (non-GAAP) to revenue ratio was 7.9%, up from 7.1% in 2Q18, mostly due to costs associated with expanding hotel development teams, upscale brands and IT capabilities. Pre-opening expense was RMB122 million, up 38.7% yoy, mainly related to upscale brand hotels.

Core net income decreased 34.3% yoy to RMB325 million. Reported GAAP net income increased 81.1% yoy to RMB613 million, benefitting from the RMB149 million unrealized gain from fair value changes of equity securities in 2Q19 compared to an RMB201 loss in 2Q18. These unrealized gains (losses) were mainly related to the Company's investment in Accor (AC PA).

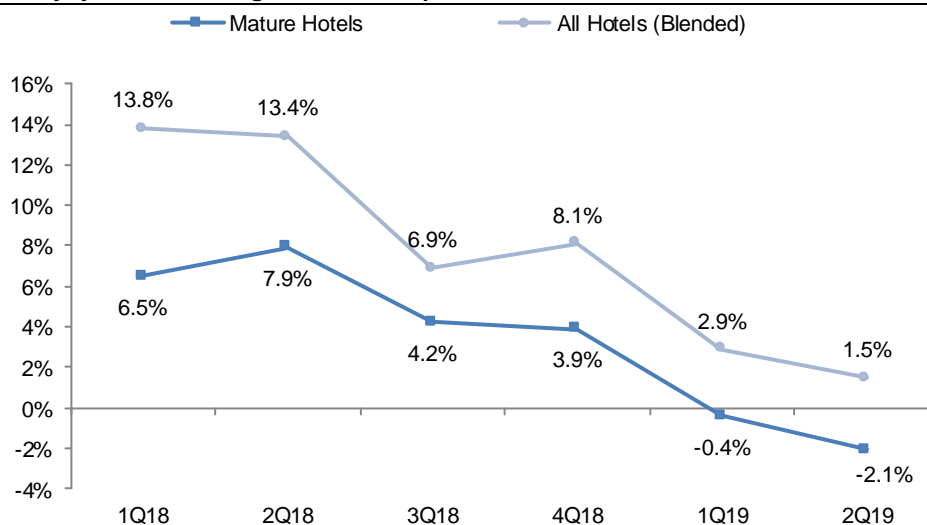
Excluding share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities, adjusted net income reported by the Company was RMB495 million, down 11.3% yoy. We take the Company's reported adjusted net income and further deduct other income, which was mainly related to gain from disposal on marketable securities, and also foreign exchange gains or loss to derive core net income and core EBITDA, which we think is a better indicator of actual performance.

Core EBITDA decreased 0.4% yoy to RMB898 million, missing our forecast by 4.9%. Excluding share-based compensation expenses and unrealized gains (losses) from fair value changes of equity securities, the Company reported adjusted EBITDA (non-GAAP) of RMB1,068 million, which increased 10.7% yoy. We take the Company's reported adjusted EBITDA and further deduct foreign exchange gains or loss and also other income of RMB135 million, which was mainly related to gain from disposal on marketable securities, to derive our core EBITDA, which we think is a better indicator of actual performance. Unrealized losses from fair value changes of equity securities was RMB149 million, which mainly resulted in market adjustment on Huazhu's investments in Accor (AC PA).

RevPAR increased 1.5% yoy to RMB206, which was attributable to higher average daily rate ("ADR"). ADR increased 4.4% yoy to RMB236, mainly due to both a positive 0.4% increase in ADR of the mature hotels, as well as an increase in the proportion of midscale and upscale hotels with higher ADR in the Company's brand mix. The occupancy rate for all hotels in operation decreased by 2.7 ppt to 86.9%, as the hotel sector occupancy rate was also down yoy due to soft performance in China's macro economy as well as a higher base in 2Q18.

For all hotels that had been in operation for at least 18 months (mature hotels), the same-hotel RevPAR decreased 2.1% yoy to RMB202. ADR increased 0.4% yoy but occupancy rate decreased 1.5 ppt yoy. The year-over-year weaker performance was mainly due to macroeconomic softness.

Figure-1: Like-for-like yoy RevPar Change for Hotels Opened for at Least 18 Months



Source: the Company, Guotai Junan International.

Table-2: Hotel Performance

	2Q18	3Q18	4Q18	1Q19	2Q19	2Q19 (% or ppt.)	
						yoy	qoq
All Hotels Blended Performance							
Avg. daily room rate (RMB)	226	239	230	221	236	4.4%	6.8%
Occupancy rate	89.6%	90.7%	85.2%	80.6%	86.9%	(2.7) ppt	6.3 ppt
RevPAR (RMB)	203	217	196	178	206	1.3%	15.7%
Mature Same Hotels							
Avg. daily room rate (RMB)	210	222	216	211	226	n.a.	n.a.
Occupancy rate	92.2%	93.2%	87.0%	83.4%	89.3%	n.a.	n.a.
RevPAR (RMB)	194	207	189	176	202	n.a.	n.a.
Mature Same Hotel yoy Growth							
Avg. daily room rate growth	7.5%	6.7%	4.9%	2.9%	0.4%		
Occupancy rate growth (ppt)	0.3 ppt	(2.3) ppt	(0.8) ppt	(2.7) ppt	(1.5) ppt		
RevPAR growth	7.9%	4.2%	3.9%	(0.4%)	(2.1%)		

Source: the Company, Guotai Junan International.

As at March 31, 2019, Huazhu had a total of 4,665 hotels (463,296 hotel rooms) in operation. During the quarter, Huazhu opened 311 hotels, including 8 leased (leased-and-operated) hotels and 303 manachised (franchised-and-managed) hotels and franchised hotels. The Company closed a total of 42 hotels, including 10 leased hotels and 32 manachised and franchised hotels during the quarter, mainly due to: 1) property related issues, including rezoning and expiry of leases, which resulted in the closure of 14 hotels; 2) 2 manachised hotels were closed due to operating losses; and 3) the Company's strategic focus to upgrade quality. The Company closed 25 hotels for brand upgrade and business model change purposes, and permanently removed 1 hotel from its network for their non-compliance with the brand and operating standards. These hotels were mainly under HanTing and Hi Inn brands. By removing hotels of lower quality, the Company has been able to provide more consistent customer experience, which will help enhance both the brands and future profitability, in our view.

During 2Q19, Huazhu decreased its proportion of economy hotels by 9.1 ppt yoy to 64.1%. As at June 30, 2019, Huazhu had 16 hotel brands aimed at all segments of the market. Midscale and upscale hotels accounted for 33.1% and 2.8% of total hotels at the end of the quarter. Since most of Huazhu's hotels are still economy hotels, we see room for profit margin growth as Huazhu continues to increase its proportion of midscale and upscale hotels, which have higher margin than economy hotels.

Table-3: Huazhu Hotels Portfolio

	2Q18	3Q18	4Q18	1Q19	2Q19	2Q19 (% or ppt.)	
						YoY	QoQ
BY BUSINESS MODEL							
L&O	673	698	699	698	696	3.4%	(0.3%)
% of Total	17.2%	17.2%	16.5%	15.9%	14.9%	(2.3) ppt	(1.0) ppt
Managed-&-Franchised ("Manachised")	3,024	3,139	3,309	3,470	3,692	22.1%	6.4%
% of Total	77.5%	77.4%	78.2%	78.9%	79.1%	1.7 ppt	0.2 ppt
Franchised	206	218	222	228	277	34.5%	21.5%
% of Total	5.3%	5.4%	5.2%	5.2%	5.9%	0.7 ppt	0.8 ppt
Total Hotels in Operation	3,903	4,055	4,230	4,396	4,665	19.5%	6.1%
BY MARKET SEGMENT							
Hanting Hotel (汉庭酒店)	2,236	2,255	2,283	2,303	2,331	4.2%	1.2%
Hi Inn (海友酒店)	395	392	402	399	415	5.1%	4.0%
Elan Hotel (怡莱酒店)	218	204	200	207	244	11.9%	17.9%
Orange Regular (桔子酒店)	8	7	7	7	0	n.a.	n.a.
Economy Hotels	2,857	2,858	2,892	2,916	2,990	4.7%	2.5%
% of Total	73.2%	70.5%	68.4%	66.3%	64.1%	(9.1) ppt	(2.2) ppt
Ji Hotel (全季酒店)	452	501	553	611	666	47.3%	9.0%
HanTing Plus Hotel (汉庭优佳)	45	59	74	91	129	186.7%	41.8%
Starway Hotel (星程酒店)	177	193	212	230	265	49.7%	15.2%
Ibis Style (宜必思)	23	28	34	37	44	91.3%	18.9%
Ibis Hotel (宜必思)	112	125	137	149	159	42.0%	6.7%
Crystal Orange (桔子水晶)	47	52	56	60	66	40.4%	10.0%
Orange Selected (桔子精选)	127	143	172	189	216	70.1%	14.3%
Midscale Hotels	983	1,101	1,238	1,367	1,545	57.2%	13.0%
% of Total	25.2%	27.2%	29.3%	31.1%	33.1%	7.9 ppt	2.0 ppt
Joya Hotel (禧玥酒店)	17	21	24	28	35	105.9%	25.0%
Man Xin (漫心度假酒店)	7	6	6	6	6	(14.3%)	0.0%
Mecure (美居酒店)	28	35	39	45	52	85.7%	15.6%
Grand Mecure (美爵酒店)	6	6	6	7	8	33.3%	14.3%
Blossom Hill (盛放山酒店)	0	21	18	20	20	n.a.	0.0%
Novotel (诺富特酒店)	5	7	7	7	9	80.0%	28.6%
Upscale Hotels	63	96	100	113	130	106.3%	15.0%
% of Total	1.6%	2.4%	2.4%	2.6%	2.8%	1.2 ppt	0.2 ppt

Source: the Company, Guotai Junan International.

Figure-2: Huazhu's Hotels by Operating Model

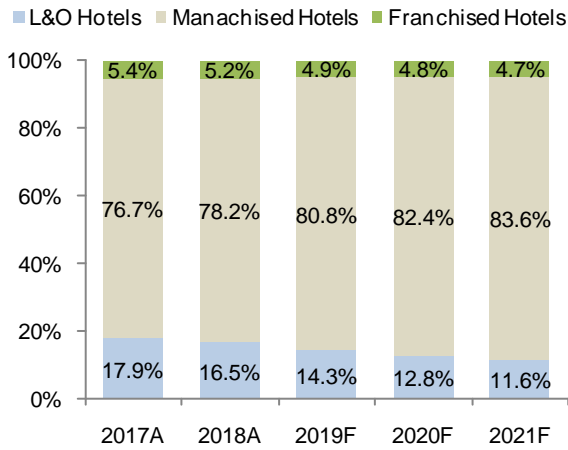
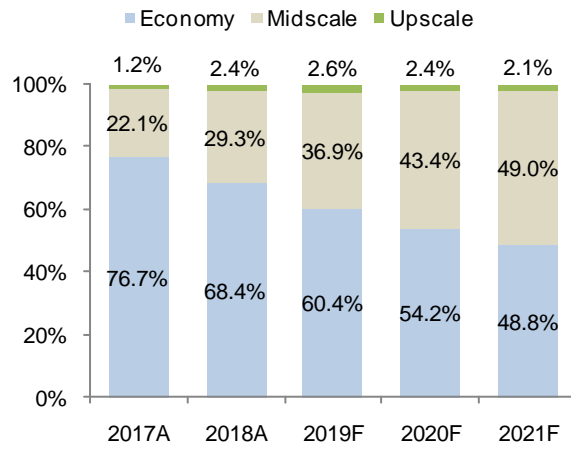


Figure-3: Huazhu's Hotels by Market Segment



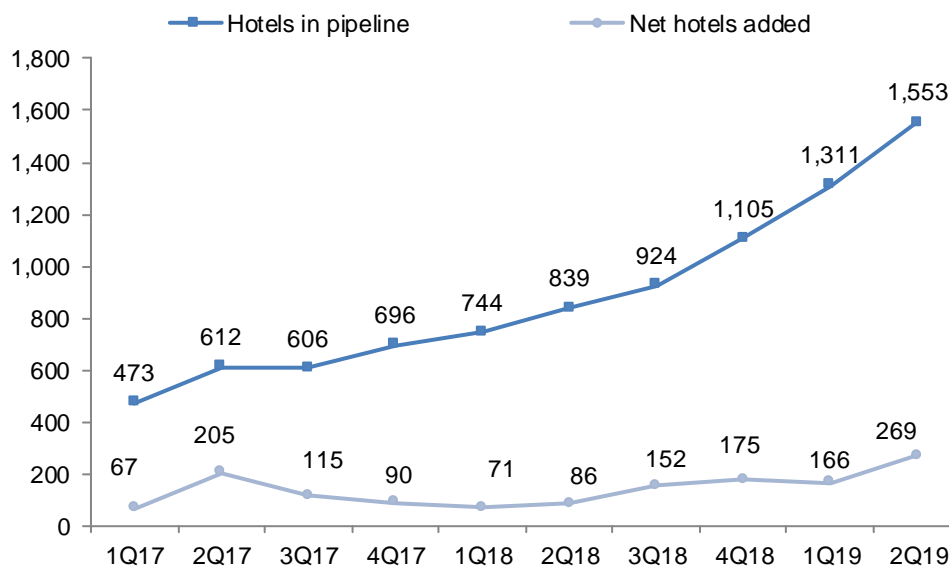
Source: the Company, Guotai Junan International.
Note: As at period end. The Company has three kinds of hotel operating models, namely: 1) leased-and-operated hotels ("L&O"); 2) franchised-and-managed hotels ("Manachised"), and; 3) franchised hotels.

Source: the Company, Guotai Junan International.

Outlook

Huazhu's management has maintained its guidance for new hotel openings in 2019 to between 850 and 1,000 net new hotels. The management has maintained its 2019 gross hotel opening target of 1,100-1,200 hotels, and hotel closure to 200-250. As at the end of 2Q19, the number of hotels under development reached a record high of 1,553 hotels.

Figure-4: Huazhu Hotels in the Pipeline and Net Hotels Added



Source: the Company, Guotai Junan International.

Huazhu gave guidance for 3Q19 net revenues to increase by 9% to 11% year-over-year, lower than expected. During 2Q19, Huazhu hotels had varying performance even in tier-1 cities, with continued growth in Beijing as well as Guangzhou, but some weakness in Shanghai and Tianjin. Overall in tier-1 cities, the RevPAR has been holding up, but in tier-2 cities Huazhu's RevPAR has experienced a significant decline in RevPar, mainly because the business activities in these areas has been slowing down. And in the lower tier-3 cities, the RevPAR has actually continued to hold up.

Huazhu announced that in September 2019, it will officially launch two new brands, Madison and Grand Madison. The Company will take existing four and five star hotels that are not Huazhu hotels and convert them into these two new brands. When joining Huazhu's network, these hotels will benefit from Huazhu's operating platforms, including IT infrastructure, procurement systems and sales channels. As of June 30, Huazhu already signed a pipeline of 12 hotels under Madison and the Grand Madison. While we expect these investments will bring additional revenue and drive margin expansion in the coming

years starting from 2020, it will pull down profitability in the short term. These hotels will incur significant pre-opening expenses and operate at a loss during the initial ramp-up period with uncertain timing on when exactly they will open and turn profitable.

We expect that more hotel openings, and especially more upscale hotel openings, will bring in more revenue and will also increase Huazhu's operating margin; but not until 2020 at the earliest. We estimate that Huazhu's operating margin will start to recover in mid- to late 2020 or 2021 since it takes at least 6 months or longer generally for new hotels to ramp up.

The Company announced that it has approved a share repurchase program for up to US\$750 million, effective for five years. The Company can make repurchases at any specific time and has no obligation to make repurchases. Huazhu management disclosed that they believe that in the current challenging economic environment, there may be some turbulence in Huazhu's share price, which could cause the share price to fall below the actually long-term fair value of the Company. We think the program is good for shareholders since will enable management to buy back some of the shares when the share price is far below the Company's long-term value. Secondly, as at June 30, Huazhu was at a net cash position of RMB5.8 billion and has some of its cash balance offshore to facilitate this share buyback.

Forecast updates

We lower our 2019-2021 net revenue forecasts by 3.1%, 10.2% and 18.7%, respectively. We forecast 2019-2021 total net revenue of RMB11.1 billion, RMB12.5 billion and RMB14.1 billion, reflecting growth of 10.3%, 12.4% and 13.1%, respectively. We expect Huazhu's revenue growth rate to slow down this year as sector growth slows down on soft performance in the macro economy. We expect Huazhu's growth rate to increase in 2020 and to further increase in 2021 on contribution from its new upscale hotels. We now expect lower RevPAR this year, which puts downward pressure on revenue.

We lower our 2019-2021 core EBITDA forecasts by 1.3%, 4.0% and 14.3%, respectively. We forecast 2019-2021 core EBITDA of RMB3.2 billion, RMB3.8 billion and RMB4.6 billion, reflecting growth of -1.5%, 19.9% and 21.4%, respectively. Core EBITDA (as well as core net income) excludes share-based compensation expenses, unrealized gains or losses from fair value changes of equity securities, foreign exchange gains or losses and other income. In 2018, Huazhu's core EBITDA margin was 31.9%. We forecast it to fall to 28.5% in 2019 on higher operating costs (including pre-opening costs) from expansion of upscale hotels. We expect margin to increase in 2020 and to further increase in 2021 as Huazhu's new upscale hotels will be ramped up and will be making a positive contribution by then. We forecast 2019-2021 fully diluted earnings per ADR of RMB5.55, RMB5.90 and RMB6.45, reflecting growth of 123.0%, 6.2% and 9.3%, respectively.

Table-4: Huazhu Forecast Update

(RMB million)	Old			New			Change (% or ppt)		
	2019F	2020F	2021F	2019F	2020F	2021F	2019F	2020F	2021F
Number of hotels in operation									
L&O hotels	701	702	705	701	702	705	0.0%	0.0%	0.0%
Manachised & franchised hotels	4,209	4,794	5,342	4,209	4,794	5,342	0.0%	0.0%	0.0%
Total hotels in operation	4,910	5,496	6,047	4,910	5,496	6,047	0.0%	0.0%	0.0%
Blended RevPAR (RMB)	217	247	263	203	216	226	(6.6%)	(12.4%)	(14.3%)
Total net revenue	11,460	13,898	17,351	11,100	12,478	14,109	(3.1%)	(10.2%)	(18.7%)
Operating profit	2,209	2,716	3,908	2,171	2,573	3,177	(1.7%)	(5.2%)	(18.7%)
EBITDA	3,472	4,398	5,782	3,573	4,195	4,990	2.9%	(4.6%)	(13.7%)
Core EBITDA	3,204	3,950	5,371	3,161	3,790	4,602	(1.3%)	(4.0%)	(14.3%)
Net income	1,715	2,275	3,267	1,725	2,093	2,573	0.6%	(8.0%)	(21.3%)
Core net income	1,447	1,826	2,856	1,313	1,689	2,186	(9.2%)	(7.5%)	(23.5%)
Earnings per ADR	6.02	7.91	11.25	6.06	7.28	8.85	0.6%	(8.0%)	(21.3%)
Fully Diluted Earnings per ADR	6.22	9.53	16.35	5.55	5.90	6.45	(10.7%)	(38.1%)	(60.6%)
Core Earnings per ADR	5.09	6.35	9.83	4.62	5.87	7.52	(9.3%)	(7.6%)	(23.5%)
Fully Diluted Core Earnings per ADR	5.22	7.66	14.30	4.21	4.75	5.47	(19.3%)	(37.9%)	(61.7%)

Source: the Company, Guotai Junan International.

Valuation

We lower our target price from US\$33.00 to US\$32.00 and downgrade our investment rating from "Neutral" to "Reduce". Long term, we are positive on Huazhu's strategy to expand into the upscale market, but we see downside pressure in the short term. However, there is risk that they might not do as well as expected competing with 4-star and 5-star hotels. Also, as this is somewhat untested waters for Huazhu, it is uncertain how long it will take for the new upscale hotels to ramp up and turn profitable. We expect costs will be higher in the short term, and we also see downside risk that it will take longer than expected for upscale hotels to ramp up, which would lead to EBITDA margin beginning to increase starting later than anticipated. Our new target price is a 17.4% discount to our DCF derived NAV of US\$38.72 and is equivalent to 23.9x forward (next four quarters) EV/Core EBITDA.

Table-5: Peers Comparison

Company	Stock Code	Currency	Last price	Market Cap	PE				EV/EBITDA				ROE(%)	BPS
					18A	19F	20F	21F	18A	19F	20F	21F	19F	19F
USA - Listed					US\$ mn									
Huazhu Group Ltd-Adr	HTHT US	USD	35.96	10,584	93.6	43.3	31.4	24.9	31.8	24.2	18.5	14.6	23.7	10.2
Intercontinental Hotels-Adr	IHG US	USD	62.86	11,443	n.a.	n.a.	n.a.	n.a.	n.a.	14.0	12.9	11.9	(49.8)	n.a.
Marriott International -CIA	MAR US	USD	130.56	43,001	24.0	21.7	19.5	17.4	22.5	14.8	14.1	13.4	122.0	43.3
Hilton Worldwide Holdings	HLT US	USD	94.86	27,211	37.5	24.7	21.9	19.4	17.8	15.0	14.2	13.5	1,044.1	(67.9)
Extended Stay America Inc	STAY US	USD	14.44	2,721	12.9	13.9	13.5	13.2	8.6	8.9	8.9	9.2	13.7	2.1
Host Hotels & Resorts Inc	HST US	USD	17.25	12,591	11.7	14.1	22.0	26.1	10.2	9.9	10.5	11.1	13.3	1.7
Hyatt Hotels Corp - CI A	H US	USD	76.33	8,004	11.2	39.7	39.0	34.0	11.7	11.7	11.1	11.3	5.7	2.2
Simple Average					31.8	26.2	24.6	22.5	17.1	14.1	12.9	12.1	167.5	(1.4)
Weighted Average					31.8	24.9	23.0	20.9	19.5	14.7	13.7	12.9	290.7	1.6
HK - Listed					HK\$ mn									
Great Eagle Holdings Ltd	00041 HK	HKD	26.90	19,055	3.2	10.2	6.6	45.6	23.2	23.2	23.2	23.2	2.7	n.a.
Hongkong & Shanghai Hotels	00045 HK	HKD	7.95	12,951	10.2	26.1	24.5	20.9	n.a.	n.a.	n.a.	n.a.	1.2	n.a.
Shangri-La Asia Ltd	00069 HK	HKD	8.15	29,222	19.3	21.7	18.4	16.5	14.6	14.6	14.6	14.6	2.7	0.6
Shanghai Jin Jiang Intl Ho-H	02006 HK	HKD	1.25	6,958	7.7	8.3	7.5	6.3	7.8	5.1	4.6	3.8	7.7	0.7
Lai Si Enterprise Holding Lt	02266 HK	HKD	0.56	224	96.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Magnificent Hotel Investment	00201 HK	HKD	0.16	1,423	5.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Asia Standard Hotel	00292 HK	HKD	0.29	585	3.4	1.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	8.4	0.1
Simple Average					20.8	13.6	14.2	22.3	15.2	14.3	14.2	13.9	4.5	0.5
Weighted Average					16.8	18.0	14.6	23.7	16.7	16.4	16.3	16.2	3.7	0.6

Source: Bloomberg, Guotai Junan International.

Table-6: Valuation and Target Price Based Multiples

	FY18A	Next 4 Quar.	FY19F	FY20F	FY21F
Target Price Based EV / EBITDA					
Target Price (US\$/ADR)	32.00				
ADR outstanding, period End (mn)	303.6	348.8	310.1	354.4	398.7
Market capitalization (US\$ mn)	9,715	11,163	9,922	11,340	12,758
+ Yr end minority interest (US\$ mn)	21	35	35	50	66
+ Yr end borrowings (US\$ mn)	1,430	1,111	1,111	847	800
- Yr end cash & equivalents (US\$ mn)	620	507	507	345	409
Year end Enterprise Value (US\$ mn)	10,547	11,803	10,562	11,892	13,214
Core EBITDA (US\$ mn)	466.6	493.0	440.0	527.5	640.7
TP based core EV/EBITDA	22.6	23.9	24.0	22.5	20.6

Source: the Company, Guotai Junan International.

Table-7: DCF Based Valuation

DCF Assumptions		Calculation	
Perpetual growth rate	3.00%	Present Value of Free Cash Flow to Equity (RMB mn)	39,250
		Present Value of Terminal Value (RMB mn)	51,492
Risk free rate	1.81%	Equity Value	90,743
Adjusted Beta	1.10	Net Debt/(cash) (RMB mn)	4,345
Market risk premium	9.34%	Minority Interest	3.3%
Cost of Equity	12.08%	Total NAV (RMB mn)	86,253
Borrowing interest rate	6.2%	ADR Outstanding (fully diluted, as at FY15 year end, mn)	310.1
Effective tax rate	26.7%	NAV per share (RMB)	278.18
Cost of Debt	4.5%	US\$:RMB	7.184
		NAV per ADR (US\$)	38.72
E/ (D+E)	49.8%		
D/ (D+E)	50.2%		
WACC	8.3%		

Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement						Balance Sheet					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F	Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F
Total revenue	8,229	10,063	11,100	12,478	14,109	PP&E	4,523	5,018	5,966	7,075	7,321
Hotel operating costs	(5,675)	(6,476)	(7,287)	(8,136)	(8,966)	Intangible assets, net	1,644	1,834	1,655	1,660	1,665
Pre-opening expense	(206)	(255)	(320)	(331)	(319)	Long term investment	2,362	6,152	6,152	6,152	6,152
S&M	(285)	(348)	(392)	(441)	(499)	Goodwill	2,265	2,630	2,630	2,630	2,630
G&A	(691)	(851)	(992)	(1,094)	(1,236)	Others	953	1,385	1,265	1,444	1,654
Other operating costs	(17)	(15)	(59)	(74)	(84)	Total non-current assets	11,747	17,019	17,668	18,961	19,422
Other operating income (expenses)	71	226	121	171	171	Cash & cash equivalents	3,956	4,884	4,299	3,181	3,677
Operating profit	1,426	2,344	2,171	2,573	3,177	Short-term investments	130	89	94	100	106
Interest income	113	148	150	140	124	Accounts receivable, net	163	194	204	222	242
Interest expense	(87)	(244)	(309)	(251)	(198)	Prepaid rent	660	955	1,001	1,088	1,190
Others	134	(952)	377	381	381	Others	852	851	896	969	1,052
Profit before tax	1,585	1,296	2,389	2,844	3,483	Total current assets	5,761	6,974	6,495	5,559	6,267
Income tax	(357)	(569)	(679)	(751)	(910)	Total Assets	17,508	23,993	24,162	24,520	25,689
Profit after tax	1,228	727	1,710	2,093	2,573	Short-term debt & accounts payable	897	1,838	1,793	1,786	1,793
Non-controlling interest	1	(11)	15	0	0	Salary & welfare payable	427	521	546	593	649
Shareholders' profit / loss	1,228	716	1,725	2,093	2,573	Deferred revenue	943	1,005	1,053	1,145	1,252
EBITDA	2,349	2,272	3,573	4,195	4,990	Accrued expenses and other current liabilities	1,249	1,607	1,684	1,831	2,002
Basic EPS	4.400	2.540	6.056	7.279	8.851	Others	255	999	1,101	1,240	1,397
Diluted EPS	4.210	2.490	5.553	5.899	6.445	Total current liabilities	3,771	5,969	6,178	6,595	7,094
						Deferred rent	1,380	1,507	1,580	1,717	1,878
						Deferred revenue	398	458	480	522	571
						Others	5,724	9,739	8,012	6,255	6,068
						Total Non-current Liabilities	7,503	11,704	10,073	8,494	8,517
						Total Liabilities	11,274	17,674	16,250	15,090	15,611
						Total Shareholders' Equity	6,198	6,174	7,658	9,068	9,607
						Minority Interest	36	145	254	363	472
						Total Equity	6,233	6,319	7,912	9,430	10,079
Cash Flow Statement						Financial Ratios					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F	2017A	2018A	2019F	2020F	2021F	
Group net income (loss)	1,228	727	1,710	2,093	2,573	L&O hotels income margin	10.5%	13.3%	6.9%	4.4%	3.7%
Share-based compensation	66	83	120	135	153	Total hotel income margin	31.0%	35.6%	34.4%	34.8%	36.5%
D&A	792	919	1,010	1,240	1,431	Operating margin	17.3%	23.3%	19.6%	20.6%	22.5%
Deferred taxes	(79)	(91)	(116)	(136)	(160)	Net profit margin	14.9%	7.1%	15.5%	16.8%	18.2%
Impairment loss	169	35	35	35	35	EBITDA margin	28.5%	22.6%	32.2%	33.6%	35.4%
Change in WC	200	58	250	419	485	Asset Turnover (x)	0.6	0.5	0.5	0.5	0.6
Others	76	1,317	10	10	10	ROA	8.9%	3.5%	7.2%	8.6%	10.2%
Cash from Operating Activities	2,453	3,049	3,020	3,797	4,528	Assets/Equity (x)	2.4	3.4	3.5	2.9	2.7
Purchase of PP&E	(820)	(1,115)	(1,950)	(2,340)	(1,669)	ROE	21.2%	11.6%	24.9%	25.0%	27.6%
Purchase of intangibles	(8)	(4)	180	(5)	(5)	Interest coverage (x)	16.3	9.6	7.0	10.3	16.0
Others	(5,408)	(5,226)	470	577	573	Net gearing	26.1%	90.3%	56.7%	39.7%	29.2%
Cash from Investing Activities	(6,235)	(6,345)	(1,301)	(1,768)	(1,101)	Debt/Equity	82.1%	159.3%	104.3%	67.1%	59.8%
Net proceeds from issuance of ordinary shares upon exercise of option	9	14	12	11	12	Current ratio (x)	1.5	1.2	1.1	0.8	0.9
Short term debt	(158)	800	(88)	(88)	(88)						
Dividends paid to ordinary shareholders	(306)	0	(438)	(1,230)	(2,576)						
Others	4,992	3,434	(1,767)	(1,818)	(255)						
Cash from Financing Activities	4,536	4,248	(2,281)	(3,124)	(2,907)						
Cash at Beg of Year	3,236	3,956	4,884	4,299	3,181						
Net Changes in Cash	753	951	(562)	(1,095)	519						
Effect of Foreign Exchanges	(33)	(23)	(23)	(23)	(23)						
Cash at End of Year	3,956	4,884	4,299	3,181	3,677						

Source: the Company, Guotai Junan International.

Company Rating Definition

The Benchmark: NASDAQ Composite Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: NASDAQ Composite Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

DISCLOSURE OF INTERESTS

- (1) The Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.
- (2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.
- (3) Except for KAISA GROUP (01638 HK), GUOTAI JUNAN I (01788 HK), JXR (01951 HK), BANK OF GANSU (02139 HK), JINSHANG BANK (02558 HK), ZHONGLIANG HLDG (02772 HK), BINHAI INVESTMENT (02886 HK), CAM SCSMALLCAP (03157 HK), HAITIAN ANTENNA (08227 HK), Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report.
- (4) Guotai Junan and its group companies have not had investment banking relationships with the issuer mentioned in this Research Report within the preceding 12 months.
- (5) Guotai Junan and its group companies are not making a market in the securities in respect of the issuer mentioned in this Research Report.
- (6) Guotai Junan and its group companies have not employed an individual serving as an officer of the issuer mentioned in this Research Report. There is no officer of the issuer mentioned in this Research Report associated with Guotai Junan and its group companies.

DISCLAIMER

This Research Report does not constitute an invitation or offer to acquire, purchase or subscribe for securities by Guotai Junan Securities (Hong Kong) Limited ("Guotai Junan"). Guotai Junan and its group companies may do business that relates to companies covered in research reports, including investment banking, investment services, etc. (for example, the placing agent, lead manager, sponsor, underwriter or invest proprietarily).

Any opinions expressed in this report may differ or be contrary to opinions or investment strategies expressed orally or in written form by sales persons, dealers and other professional executives of Guotai Junan group of companies. Any opinions expressed in this report may differ or be contrary to opinions or investment decisions made by the asset management and investment banking groups of Guotai Junan.

Though best effort has been made to ensure the accuracy of the information and data contained in this Research Report, Guotai Junan does not guarantee the accuracy and completeness of the information and data herein. This Research Report may contain some forward-looking estimates and forecasts derived from the assumptions of the future political and economic conditions with inherently unpredictable and mutable situation, so uncertainty may contain. Investors should understand and comprehend the investment objectives and its related risks, and where necessary consult their own financial advisers prior to any investment decision.

This Research Report is not directed at, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject Guotai Junan and its group companies to any registration or licensing requirement within such jurisdiction.

© 2019 Guotai Junan Securities (Hong Kong) Limited. All Rights Reserved.
 27/F., Low Block, Grand Millennium Plaza, 181 Queen's Road Central, Hong Kong.
 Tel.: (852) 2509-9118 Fax: (852) 2509-7793
 Website: www.gtja.com.hk