

BCP Research: Huazhu Hotels Group (HTHT): - New Issuance, 4Q19 and 1Q20 Preliminary Results - Maintain Neutral

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Summary: Chinese hotel operator, Huazhu Hotels Group (“Huazhu”) has issued US\$450 mm in new convertible senior unsecured HTHT 3% 05/01/2026 notes with a 30-day greenshoe option for an additional US\$50 mm available to initial purchasers. Notes are convertible into ADSs (1 ADS = 1 ordinary share) at a strike price of US\$41.72 (conversion rate of 23.9710 per US\$1,000 principal) v. current stock price of US\$32.52. Proceeds for the new converts will be used to repurchase of existing HTHT 0.375% 22s as well as repay principal and interest on certain of its loans.

The company's performance in 4Q19, while softened sequentially as a result of COVID-19, managed to produce positive y/y growth, with margins expanding to 30% and cash generation (pre-wk) of US\$32 mm (RMB 225 mm). Meanwhile, Huazhu's debt expanded further, reaching US\$5.5 bn (RMB 38.1 bn, +27% q/q) with the funding of the ~US\$800 mm Deutsche Hospitality acquisition, which closed January 2nd 2020, via new and/or refinanced loans. This, alongside softer adj. EBITDA, resulted in q/q expansion of LTM net leverage to 9.5x.

At March 31st 2020, the company had 5,953 hotels in operation (excl. requisition hotels). Preliminary 1Q20 results indicate lower blended RevPAR (-51% y/y in RMB), and revenue decline of 45-57% y/y in RMB terms), implying revenues of US\$147-188 mm (RMB1,026 - 1,313 mm) for 1Q20 compared to US\$388 mm (RMB 2,387 mm) in the 1Q19. We highlight preliminary results exclude Deutsche Hospitality (“DH”) and operations related to government requisition for quarantine and medical purposes, which won't be recognized until settlement. DH temporarily closed 85 of its hotels on March 31st 2020 as a result of COVID-19, while China began reopening during 2Q20.

The company has maintained its target of 10,000 hotel openings in the next three to five years, guiding to 1,600 – 1,800 hotel openings and 300 – 350 closures (50 – 100 COVID-19 related) in FY20, which feels ambitious under current market conditions. While adj. EBITDA and cash flow have remained positive, the already elevated debt balance remains a concern – particularly given the anticipated profitability weakness in 1H20 and temporary closure of the majority of hotels at Huazhu's newly acquired subsidiary, DH, in the wake of COVID-19.

Other PRC names such as such as CHIGRAU and CARINC (even prior to Luckin scandal) or global EM travel CPA (Copa) 25s, have relatively low leverage yet have been impacted by the weak macroeconomic environment, yet trade well over 1,000 bps. This informs our spread of 1,000 bps on the new HTHT 26s and 600 bps on the earlier-dated HTHT 22s, given the new issuance and subsequent inflow of cash. Inputs implies HTHT 26s and 22s are 11% and 7% cheap to model with realized vol capped at 50%. Given the elevated leverage here and uncertain outlook we are 'Neutral' on both the existing HTHT '22s and new HTHT '26s. We look forward to understanding the impact of COVID-19 in more detail with the release of 1Q20 results.

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	CPA US Price
HTHT 0.375% 11/1/2022	475	99.8	0.92%	33.02%	5.87%	41.99%	44.78	\$32.52
HTHT 3% 05/01/2026	450	98.1	3.51%	29.64%	10.64%	79.14%	41.72	\$32.52

* Source: Equity information sourced from Bloomberg. Convertible pricing as of May 13th 2020.

Details of New Sr. Unsecured HTHT 3% 05/01/2025 Convertible Bond:

- **Issuer:** Huazhu Group Ltd
- **Amount:** US\$450 mm (with option to issue an additional US\$50 mm)
- **Rank:** Senior Unsecured
- **Interest:** 3% S/A (1st coupon Nov. 1st 2020)
- **Maturity:** May 1st 2026
- **Settlement:** Convertible into ADSs (1 ADS = 1 ordinary share) at a strike price of US\$41.72 (conversion rate of 23.9710 per US\$1,000 principal)
- **Optional redemption:** Bondholders may require the company to redeem bonds at par on May 1st 2024 or in the event of certain fundamental changes
- **Market of Issue:** Private Placement
- **Investor Eligibility:** Qualified Institutional Buyers and non-U.S. persons outside of the United States
- **Use of proceeds:** Net proceeds will be used towards the repurchase of existing HTHT 0.375% 22s as well as repay principal and interest on certain of its loans

Preliminary 1Q20 Performance and FY20 Guidance:

- Results disclosed exclude Deutsche Hospitality (“DH”) operations and operations related to government requisition:
 - DH closed 85 of its hotels on March 31st 2020 as a result of COVID-19
 - Operations related to government requisition (quarantine/medical purposes) account for 610 of Huazhu’s hotels in operation. Revenues related to these operations will not be recognized until settlement.
- At March 31st 2020, the company had 5,953 hotels in operation
- Blended RevPAR for 1Q20 down 50.5% y/y to RMB 178 (USD 21)
- Blended average daily room rate down 14.6% y/y at RMB 221 (USD 25)
- Blended occupancy rate down 33.9 p.p. to 80.6%
- Est. revenue decline of 45-57% y/y in RMB terms, implying revenues of US\$147-188 mm (RMB1,026 - 1,313 mm) for 1Q20 compared to US\$388 mm (RMB 2,387 mm) in 1Q19
- 1H20 EBITDA is expected to be weaker as a result of rental cost reductions, which will be spread through the life of the lease period
- At March 26th 2020 the company had RMB 2.1 bn (US\$0.3 bn) available in unutilized credit facilities
- FY20 Guidance: Adjusted for the impact of COVID-19, Huazhu expects to open 1,600 – 1,800 hotels (v. 1,700 previously), and close 300 – 350 hotels, including 50 – 100 specifically impacted by COVID-19
 - In addition, the company maintains its target to open 10,000 hotels within the next 3-5 years

4Q19 Financial and Operational Performance:

- Huazhu had a total of 5,618 hotels in operation (+33% y/y, +9% q/q), of which 12% were leased and owned, and 88% were manachised/franchised
 - Hotels covered 437 cities and included a total of 536,876 rooms (16% leased, 84% manachised/franchised)
 - Manachised increased 37% y/y and Franchised hotels increased 85% y/y, and remained flat q/q
 - Hotels covered 437 cities (34 new cities since 4Q18) and included a total of 536,876 rooms (84% manachised/franchised, 16% leased and owned)

- Huazhu opened a total of 1,715 hotels in 2019, exceeding the original plan of 1,100 - 1,200 by 50%
 - Total pipeline was of 2,262 hotels, twice the 2018 figure of 1,105
- Average Daily Rate (“ADR”) in 4Q19 increased 1% y/y and decreased 5% q/q to RMB 232 (USD 32.97)
- Occupancy rate was 82% and RevPAR was RMB 191 (USD 27.10), down 3% y/y and 11% q/q
- Revenue of RMB 2,910 mm (US\$414 mm) increased 8% y/y 11% when comparing FY19 with FY18, in line with company guidance of 10%-12% FY growth
 - Leased and owned hotels’ 4Q19 top line decreased 1% y/y and 8% q/q to RMB 1,921 mm (US\$273 mm) on lower RevPAR and temporary hotel closures as upgrades were implemented
 - Revenues from Manachised/Franchised hotels increased 33% y/y and were flat q/q at RMB 938 mm (US\$133 mm), and now account for 32% of total revenue v. 26% in 4Q18
- Adjusted EBITDA was RMB 861 mm (US\$122 mm), up 17% y/y and down 4% q/q, excluding share-based compensation expenses and unrealized gains/(losses) from changes in fair value of equity securities (primarily the mark to market on the 4.8% interest in Accor, worth approximately US\$600 mm)
- Adj. EBITDA margin expanded 213 bps y/y and 9 bps q/q to 30%
- Free cash flow (pre-wk) was positive RMB 225 mm (US\$32 mm), benefitting from strong Adj. EBITDA performance and lower tax expenses, which outweighed higher interest payments and capex
 - Capex was RMB 459 mm (US\$57 mm), increasing 47% y/y and 18% q/q, negatively impacting cash generation
 - Tax decreased slightly q/q to RMB 133 mm (US\$5 mm)
- Gross debt at 4Q19 was RMB 38,161 mm (US\$5,480 mm), up 27% q/q on funding for the DH acquisition
 - Operating leases, which accounted for RMB 21,578 mm (US\$3,099 mm) of gross debt and were flat q/q
 - Meanwhile, loans increased 90% q/q to RMB 16,583 (US\$2,381 mm) due to funding of the DH acquisition, which closed on January 2nd 2020
 - The ST portion of this loan debt, totaling RMB 8.5 bn (US\$1.2 bn), includes the syndicated loan (US\$500 mm), convertible notes (US\$472 mm), fully cash-backed bank debt (US\$220 mm) and ST portion of LT bank debts (US\$28 mm)
- Cash and equivalents for the period were RMB 6,142 mm (US\$882 mm)
 - The company had an unutilized credit facility totaling US\$1,699 mm (US\$244 mm) at end Dec ‘19
 - Huazhu has an additional RMB 10,765 mm (US\$1,546 mm) in restricted cash split between US\$800 mm for the DH acquisition, US\$500 mm in reserved cash for refinancing of their syndication loan and US\$220 mm of cash pledged to certain bank borrowings
- Net debt was RMB 32,019 mm (US\$4,598 mm)
- LTM Net Leverage (Net debt / LTM Adj. EBTIDA) was 9.5x
- Guidance: 4Q19 and FY19 results were in line with company guidance
- We highlight that Huazhu Hotels Group concluded the acquisition of Deutsche Hospitality on January 2nd 2020, further expanding its’ up-scale brand portfolio and overseas presence
 - DH is expected to contribute to 25% of total top line in 2020
 - However, due to lower margins, profit contribution is expected to be around 5%-10%

	ASC 842	ASC 842	ASC 842	ASC 842		ASC 842	
HTHT (RMB MM)	4Q19	3Q19	2Q19	1Q19	4Q18	y-o-y	q-o-q
ADR	232	245	236	221	230	1%	(5%)
Occupancy Rate	82%	88%	87%	81%	85%	(300 bps)	(550 bps)
RevPAR	191	215	205	178	196	(3%)	(11%)
RevPAR (Hotels 18+ mo.)	n/a	n/a	n/a	176	189	-	-
Total hotels in operation	5,618	5,151	4,665	4,396	4,230	33%	9%
Leased and owned hotels	688	697	696	698	699	(2%)	(1%)
Manachised hotels	4,519	4,087	3,692	3,470	3,309	37%	11%
Franchised hotels	411	367	277	228	222	85%	12%
Total hotel rooms in operation	536,876	504,414	463,296	439,614	422,747	27%	6%
Leased and owned hotels	87,465	88,206	87,179	87,766	86,787	1%	(1%)
Manachised hotels	418,700	387,174	351,128	330,568	314,932	33%	8%
Franchised hotels	30,711	29,034	24,989	21,280	21,028	46%	6%
Number of cities	437	420	413	404	403	8%	4%
Revenue	2,910	3,055	2,859	2,387	2,683	8%	(5%)
Leased and owned hotels	66%	68%	70%	71%	72%	(637 bps)	(237 bps)
Manachised and franchised hotels	32%	31%	28%	28%	26%	603 bps	150 bps
Others	2%	1%	2%	1%	1%	33 bps	87 bps
Net income(loss)	619	431	613	106	(419)	(248%)	44%
Interest income	(39)	(46)	(41)	(33)	(32)	20%	(15%)
Interest expense	83	72	83	77	70	18%	15%
Income tax expense	133	191	286	31	106	25%	(30%)
Depreciation and amortization	273	250	245	231	229	19%	9%
EBITDA	1,069	898	1,186	412	(46)	-	19%
EBITDA margin	37%	29%	41%	17%	-2%	-	734 bps
Share-based compensation	22	31	31	26	27	(18%)	(29%)
Unrealized (gains) losses from fair value changes of equity securities	(230)	(28)	(149)	90	756	(130%)	721%
Adj. EBITDA	861	901	1,068	528	737	17%	(4%)
Adj. EBITDA margin	30%	29%	37%	22%	27%	213 bps	9 bps
Interest expense	(44)	(26)	(42)	(44)	(38)	17%	69%
Tax expense	(133)	(191)	(286)	(31)	(106)	25%	(30%)
Capex	(459)	(390)	(301)	(384)	(312)	47%	18%
Free cash flow (before WK)	225	294	439	69	281	(20%)	(23%)
Gross debt	38,161	30,105	30,578	31,014	9,760	291%	27%
Operating lease liabilities	21,578	21,394	21,410	20,994	n/a	-	1%
Loans and Bonds	16,583	8,711	9,168	10,020	9,760	70%	90%
Cash and Equivalents	6,142	4,076	3,422	3,924	4,351	41%	51%
Net debt	32,019	26,029	27,156	27,090	5,408	492%	23%
LQA Gross leverage (Gross Debt/ LQA Adj. EBITDA)	11.1x	8.4x	7.2x	14.7x	3.3x	7.8x	2.7x
LQA Net leverage (Net Debt/ LQA Adj. EBITDA)	9.3x	7.2x	6.4x	12.8x	1.8x	7.5x	2.1x
LTM Gross leverage (Gross Debt/ LTM Adj. EBITDA)	11.4x	9.3x	9.2x	9.6x	3.0x	8.4x	2.1x
LTM Net leverage (Net Debt/ LTM Adj. EBITDA)	9.5x	8.0x	8.1x	8.4x	1.7x	7.9x	1.5x
Average fx:	7.0361	7.0164	6.8218	6.7482	6.9201	2%	0%
End fx:	6.9632	7.1483	6.8668	6.7121	6.8785	1%	(3%)

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HTHT (US\$MM)	4Q19	3Q19	2Q19	1Q19	4Q18	y-o-y	q-o-q
ADR	32.97	34.92	34.59	32.75	33.24	(1%)	(6%)
Occupancy Rate	82%	88%	87%	81%	85%	(300 bps)	(550 bps)
RevPAR	27.10	30.62	30.06	26.40	28.32	(4%)	(11%)
RevPAR (Hotels 18+ mo.)	-	-	-	26.08	27.31	-	-
Total hotels in operation	5,618	5,151	4,665	4,396	4,230	33%	9%
Leased and owned hotels	688	697	696	698	699	(2%)	(1%)
Manachised hotels	4,519	4,087	3,692	3,470	3,309	37%	11%
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Franchised hotels	30,711	29,034	24,989	21,280	21,028	46%	6%
Number of cities	437	420	413	404	403	8%	4%
Revenue	414	435	419	354	388	7%	(5%)
Leased and owned hotels	66%	68%	70%	71%	72%	(637 bps)	(237 bps)
Manachised and franchised hotels	32%	31%	28%	28%	26%	603 bps	150 bps
Others	2%	1%	2%	1%	1%	33 bps	87 bps
Net income(loss)	88	61	90	16	(61)	(245%)	43%
Interest income	(6)	(7)	(6)	(5)	(5)	18%	(15%)
Interest expense	12	10	12	11	10	16%	15%
Income tax expense	19	27	42	5	15	23%	(31%)
Depreciation and amortization	39	36	36	34	33	17%	9%
EBITDA	152	128	174	61	(7)	-	19%
EBITDA margin	37%	29%	41%	17%	-2%	-	734 bps
Share-based compensation	3	4	5	4	4	(19%)	(29%)
Unrealized (gains) losses from fair value changes of equity securities	(33)	(4)	(22)	13	109	(130%)	719%
Adj. EBITDA	122	128	157	78	106	15%	(5%)
Adj. EBITDA margin	30%	29%	37%	22%	27%	213 bps	9 bps
Interest expense	(6)	(4)	(6)	(7)	(5)	15%	69%
Tax expense	(19)	(27)	(42)	(5)	(15)	23%	(31%)
Capex	(65)	(56)	(44)	(57)	(45)	45%	17%
Free cash flow (before WK)	32	42	64	10	41	(21%)	(24%)
Gross debt	5,480	4,211	4,453	4,621	1,419	286%	30%
Operating lease liabilities	3,099	2,993	3,118	3,128	n/a	-	4%
Loans and Bonds	2,382	1,219	1,335	1,493	1,419	68%	95%
Cash and Equivalents	882	570	498	585	633	39%	55%
Net debt	4,598	3,641	3,955	4,036	786	485%	26%
LQA Gross leverage (Gross Debt/ LQA Adj. EBITDA)	11.2x	8.2x	7.1x	14.8x	3.3x	7.9x	3.0x
LQA Net leverage (Net Debt/ LQA Adj. EBITDA)	9.4x	7.1x	6.3x	12.9x	1.8x	7.5x	2.3x
LTM Gross leverage (Gross Debt/ LTM Adj. EBITDA)	11.3x	9.0x	9.1x	9.5x	2.9x	8.4x	2.3x
LTM Net leverage (Net Debt/ LTM Adj. EBITDA)	9.5x	7.8x	8.1x	8.3x	1.6x	7.9x	1.7x
Average fx:	7.0361	7.0164	6.8218	6.7482	6.9201	2%	0%
End fx:	6.9632	7.1483	6.8668	6.7121	6.8785	1%	(3%)

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“Market Underweight” – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

“Not Rated” or no comment – Currently, the analyst does not have adequate conviction about the bond’s spread to its similarly duration sovereign controller bond over the next 3 – 6 months.

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“Speculative Buy” – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

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