MIRAMAR HOTEL AND INVESTMENT COMPANY

Group 7 – MBA 1

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Screening: Potential Value Investing Stock

Miramar Hotel and Investment Company (Miramar) is a HK small-cap[1] corporation with a market capitalization of about HK$11,525 million which suggest that it may be a value investing stock. The P/E ratio is at 12.9x, which just qualifies it as a possible value stock. The M/B is at 0.71x which is below the threshold to be considered a value stock. In addition, Miramar has no analyst coverage, which indicates that it may be a value stock. The company is not under financial distress and it is not a spin off corporation which are both indicators that this is not a value stock. With minimal growth and steady margins, this company Is considered a low growth stock and is likely a value investing stock. All of the above factors indicate that Miramar is a value investment stock.

Valuation

Business Risk: Medium

Miramar has four related business segments; Hotels and Serviced Apartments, Property Rental, Food and Beverage, and Travel business. Within Hong Kong, tourism and travel has been traditionally strong and is currently growing. The Food and Beverage industry is highly competitive with low EBITDA margins. Miramar Group operates both a chain of travel agencies within Hong Kong as well as a cruise and car rental booking service for travellers which relies upon consumer discretionary spending. Based on the points above, we have determined that the business risk is medium.

Financial Risk: Low; AA-A rating

Miramar's current strategy is to eliminate most of their debt and have a low capital structure. Even though in previous years the company's capital structure was higher, management has indicated they want to eliminate their debt and have executed on their promise. Currently, they have no material long term debt and their overall capital structure is 3.1%. As a company with medium business risk, this capital structure suggest that Miramar also has low financial risk, giving it a rating of AA-A rating and a 4% ERP.

WACC: 6.48%; First Pass ROIC: 5.04%

WACC has been calculated at 6.48% based on a target capital structure of 3.1% debt, cost of debt of 2.62%, cost of equity of 6.6% and tax rate of 16.5%. The first pass ROIC was calculated at 5.04%. This would make ROIC less than WACC and we expect investment and growth in the company to decrease its value. Based on this, it is hypothesized that NAV would be greater than EPV.

Net Asset Value (NAV): HK$25.34/share

NAV was calculated at HK$17,510 million with NAV/Share at HK$25.34 In calculating NAV, customer relations were computed at HK$180.74 million and adjusted PPE was at HK$279 million.

Earnings Power Value (EPV): HK$20.99/share; Second Pass ROIC: 4.3%

EPV was calculated at HK$14,504 million with EPV/Share at HK$20.99. Zero growth free cash flows were calculated by normalizing EBIT and accounting for the one-time charges.

With NAV and EPV calculated, it can be seen that NAV is greater than EPV, which confirms the initial hypothesis. With the EPV calculation, the ROIC second pass can be obtained and is 4.3%. The NAV/EPV ratio of 1.2 is also in the range of the WACC/ROIC ratio of 1.5.

Decision

Intrinsic value: HK$22.73/share; Entry price: HK$15.15/share; Do Not Buy Recommendation

As NAV> EPV, the intrinsic value will be evaluated based on the probability of a catalyst increasing the value of the stock to the intrinsic value. This catalyst is based on management, excess capacity and competitive disadvantage. The management is being too conservative and reducing debt levels considerably, therefore they are not within their capital structure and it is increasing their WACC. They also have too much capacity and need to shrink their business to gain value. Management is currently doing this as evident by their closing of several unprofitable divisions in the past few years. The industries that they are in are highly competitive with low barriers to entry and it does not seem that a regulatory body will step in and create barriers to entry. Considering these factors, a probability of the catalyst of 0.40 was used which provided an intrinsic value per share of HK$22.73. By applying the margin of safety, an entry price of $15.15 was calculated, which is below the current stock price of $16.68. As a result, Miramar is not a value stock and a strong do not buy is recommended. However, it may warrant continued observation as the entry price is in close proximity to the current stock price.

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[1] Small-Cap on the HKSE $2.9 billion USD - https://www.msci.com/documents/10199/73920289-8584-47fb-af65-7f57845bfb38