Internal Assessment
~~Research project~~
Business and Management SL

INTERNATIONAL BACCALAUREATE

Should the intercontinental Hotel group buy Fairmont Raffles International Hotels?

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Introduction

The InterContinental Hotel Group, or IHG, is a large hotel chain founded in 2003. (ihg.com History) The hotel chain has a large amount of hotels and resorts all over the world and has profited largely because of this. Recently, IHG has been rumoured to make offers to buy a different hotel chain called Fairmont Raffles Hotels International. (Fletcher Intercontinental hotels could benefit from Fairmont deal) IHG has reportedly offered three billion US Dollars to Fairmont to buy the company and its hotels. Fairmont has a large amount of luxury hotels, including some hotels in historical building. However, this deal could potentially be very destructive for IHG and could hurt their appearance to the customers. This is because IHG is largely known for middle class hotels such as the Holiday Inn chain. Therefore, IHG should consider whether buying the Fairmont hotels would be profitable for them in the long run. Therefore it should be asked: *Should The Intercontinental Hotel Group buy Fairmont Hotels?* Intercontinental has not released any statements about this deal and therefore this report would be very beneficial to them. This problem will be discussed by looking at the cash flow of IHG. This will indicate whether IHG has the resources to buy the Fairmont chain. Furthermore a force field analysis will be made to look at factors influencing the decision that IHG has to make. These methods will indicate whether IHG will profit from buying Fairmont hotels.

Intercontinental hotel group: cash flow and profit/loss account

The cash flow of the Intercontinental Hotel group will be looked at. (Fletcher Intercontinental hotels could benefit from Fairmont deal) From their cash flow it can be seen that IHG has been making less profits for the last three years. In 2012, IHG had 195,000,000$, whereas at the end of 2014 they only had 55,000,000$. This means that if the IHG will potentially start to lose money within two years. Furthermore, the net cash flow at the end of 2014 shows that based on revenue made by hotels, the IHG will not have enough money to buy Fairmont hotels. The Income statement does show that IHG has 392,000,000$ of net profit after tax, however this is decreased to 55,000,000$ in the cashs flow. This means that a large amount of profit is lost due to liabilities that the company has.

Preparation for Fairmont deal

IHG has sold two of their hotels in order solidify their financial position and this allows them to confidently buy Fairmont hotels. (Hotelmanagement.net why IHG acquiring Fairmont is the right thing to do) IHG has sold one of their hotels in Hong Kong for 938 million US dollars and one of their hotels in Paris for 366 million Dollars. This means that recently IHG has made room both financially and departmentally for a large merger such as that with Fairmont. The merger with Fairmont can also be compared with an earlier merger of IHG with Kimpton hotels. Kimpton hotels are a large independent hotel group and it was bought by IHG at the end of 2014. This merger instantly boosted the public view of IHG and they now receive revenue from costumers that previously only went to Kimpton hotels. The same result can occur if IHG takes over Fairmont.

Analyst's Opinions

The IHG hotel chain admitted to journalists of Morgan Stanley that it has a gap in their market because of a lack of Luxury hotels. (Sarah Williams Analysts say Fairmont deal good for IHG) The Fairmont hotel chains have several Luxury hotels meaning that a merger between IHG and Fairmont might be very beneficial for IHG considering they will have access to a larger potential customer market because consumers interested in luxury hotels could now also make use of the IHG brand. Jamie Rollo, a journalist from Stanley Morgan, said:

"Having performed well both operationally and financially since its 2003 demerger, and with the Hong Kong and Paris hotel disposals completing its move to an asset light model, we think InterContinental management feel they are in a strong position to invest for growth." (Fletcher Intercontinental could benefit from Fairmont deal)

Force Field analysis

Generally, anagree that the IHG and Fairmont merger would be beneficial to IHG as it allows for a lot of expansion to new markets and consumers. However, there are other factors that IHG has to consider before committing to the merger. First of all, a force field analysis will show the positive and negative forces that can affect the outcome of the merger.

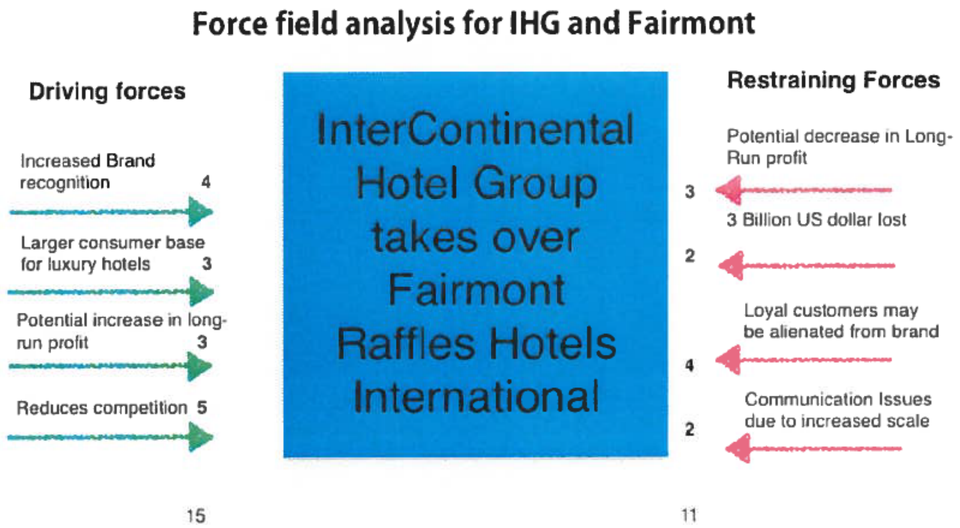

Fig. 1

Fig. 1 identifies driving and restraining forces that IHG may face if it takes over Fairmont. The Driving forces outnumber the Restraining forces with 15 to 11, meaning that according to the force field analysis the decision to take over Fairmont would be a good decision to make. IHG has to be very mindful of their brand and how it can affect their costumer base. The way this merger happens can influence the public view and opinion about IHG heavily, and thus increase brand recognition. Current customers of IHG may feel that the merger with Fairmont makes the chain more luxurious. This can be a good thing because generally consumers will want more luxury, but it can change how people perceive the brand and therefore become alienated from it. To solve this, IHG could use the same strategy as with the Kimpton Hotel merger and maintain the Fairmont brand for the hotels that IHG takes over.

Furthermore, the take over can potentially cause the hotel chain to become too big. The IHG brand has a very large amount of hotels under its name and the addition of several other large hotels could make the scale of the IHG too large. The size of the company could potentially lead to a decrease in the motivation of the employees and also to the management of the hotels and therefore how the customers experience it. The magnitude of the chain can cause the employers to feel as if they are not a part of the company. However, because the company was already multinational and already had a large scale, this will most likely not be a large issue. In fact, the removal of a big competitor to IHG means that the market share of IHG will increase because there is less competition. The reduced competition will therefore also increase IHG chances of being the market leader for hotel chains around the world.

Globalization

Globalization has become easier due to several factors. First of all, communication has improved drastically meaning that IHG can communicate with all their hotels around the world quickly due to the Internet, even though it is a large company. This is also important for the company to express their core aims and business objectives to all the employees. Secondly, Trade barriers are being dismantled internationally, meaning that IHG can transport and import the resources they require more easily. Thirdly, The world's financial market is being deregulated meaning that funds can be transferred more easily. And lastly, the economic and political powers of businesses such as IHG have increased, which allows for a large amount of benefits for the country of origin. (Loykie Business Management course companion)

Conclusion

The decision of the InterContinental Hotel Group seems to be a good decision to make. This mainly based off of the Force field Analysis. The Driving forces outweigh the restraining forces and therefore the deal will most likely be successful. Additionally, although the cash flow of IHG is currently not enough, they have reserved cash from selling some of their hotels in order to be able to afford the Fairmont deal. The deal will also enable the IHG do have a large market share and also potentially cater to more customers, meaning that IHG go ahead continue the merger with Fairmont.

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Appendices

Yellow areas are focused areas

Company said to be close to buying Savoy Hotel owner for £1.9bn

Savoy owner said to be up for sale.

InterContinental Hotels is reportedly close to buying Fairmont Raffles, which owns luxury assets such as the Savoy in London, and Morgan Stanley analysts are positive on the idea.

The bank said any such deal would be a good fit for InterContinental, since it is weak in the luxury segment, although Fairmont was likely to command a high price. With a possible $1.5bn buyback by InterContinental, a purchase of Fairmont for a reported £1.9bn would make it hard to boost earnings per share in a material way if the share repurchase went ahead. Morgan Stanley's Jamie Rollo said:

Press reports (Sunday Times) suggest that InterContinental is closing in on a deal to buy Fairmont Raffles for £1.9bn. Sources suggest InterContinental has beaten rivals including Wyndham and Accor, and is likely to seal the deal "within weeks". Neither party has commented, but we note that InterContinental has not put out a statement denying the rumour, as it did after the Starwood takeover rumour (though the company said it was required by the authorities to put out a statement that time).

Fairmont, which as well as the Savoy also owns the Plaza in New York, the Peace Hotel in Shanghai, and Raffles Singapore, is owned by Qatar-based Katara Hospitality and Saudi Arabia-based Kingdom Holdings. It would fit with InterContinental, given the company recently admitted a strategic gap in the luxury market.

InterContinental also has funds available. It is about to receive $930m from the sale of its Hong Kong hotel and still has $363m from the sale of its Paris hotel. Morgan Stanley's Rollo said:

Having performed well both operationally and financially since its 2003 demerger, and with the Hong Kong and Paris hotel disposals completing its move to an asset light model, we think InterContinental management feel they are in a strong position to invest for growth. Unencumbered luxury hotel brands don't come around that often, and the conundrum InterContinental likely faces is having to justify a multiple potentially double that on which its shares trade, and thus forfeit the more immediate and relatively safer upside from a large share buyback.

With its shares on under 11 times 2016 estimated EBITDA and 17 times PE (post our current assumption of a $1.5bn buyback), we think they are good value for a high quality hotel business operating in a cycle where we see further upside, and we rate them overweight.

However in a falling market InterContinental is currently down 56p at £22.72.

Why IHG acquiring Fairmont is the right, smart move

The M&A market is percolating and a familiar name is providing the stir.
InterContinental Hotels Group, which already made a splash earlier this year through it's acquisition of Kimpton Hotels, is now reportedly closing in on buying Fairmont Raffles Hotels International for close to US$3 billion.
In June, reports surfaced that Toronto-based FRHI's owners, a Qatari government fund and Saudi Prince al-Waleed bin Talal's Kingdom Holding Company, was putting the group, which includes the Fairmont, Raffles and Swissotel brands, up for sale.
FRHI operates 116 hotels with nearly 44,000 rooms in 34 countries. The list includes historic luxury properties such as New York's Plaza Hotel, the Peace Hotel in Shanghai and the Savoy in London.

Now, in comes IHG, the UK-based hotel group, which was first mentioned as a potential suitor for Starwood Hotels & Resorts Worldwide, something it sidestepped.
Last November, IHG shareholder Marcato Capital Management reportedly pushed IHG for some type of merger or consolidation, with Starwood, Marriott, Hilton, Wyndham, Hyatt and Accor listed as possibilities. "Each of these companies would be a fit for IHG by broadening its geographic footprint in the most desirable hospitality markets, expanding chain scale diversification, increasing asset-light earnings, realizing cost savings, improving system fund benefits and lowering cost of capital," Marcato said.
But no mention of Fairmont, until now. IHG has now reportedly beaten out others vying for Fairmont, including Wyndham and Accor, and a deal will reportedly be reached within the next few weeks.
IHG, which continues to transition out of real estate to pure hotel operator, appears to have the capital to make the acquisition. Divesting properties is part of the reason why.
In July, IHG agreed to sell its full ownership of the InterContinental Hotel Hong Kong to Hong Kong-based private real estate investment firm Gaw Capital Partners for $938 million.

IHG, owner of the Holiday Inn and Crowne Plaza brands, among other well-recognized flags, has been divesting properties of late, evidenced by the Hong Kong sale. Last December, it accepted a $366-million cash offer from Constellation Hotels Holding Ltd. for Le Grand hotel in Paris.

"Having performed well both operationally and financially since its 2003 demerger, and with the Hong Kong and Paris hotel disposals completing its move to an asset-light model, we think InterContinental management feel they are in a strong position to invest for growth," Morgan Stanley's Jamie Rollo told UK's The Sunday Times. "Unencumbered luxury hotel brands don't come around that often, and the conundrum InterContinental likely faces is having to justify a multiple potentially double that on which its shares trade, and thus forfeit the more immediate and relatively safer upside from a large share buyback."

A FRHI acquisition would give IHG instant growth in the luxury market, something it has in its InterContinental brand, but not to the same degree of brand awareness as Fairmont and Raffles provide. IHG is known more for its midscale offerings in the form of Holiday Inn and Holiday Inn Express.

In the same way its Kimpton buy immediately grew its lifestyle footprint, the FRHI deal would do the same for the luxury space.

As hotel companies shift from real estate companies to operators, acquiring legacy, well-established brands is a shrewd way to grow. Without having to build new hotels, it gives companies instant access to derive fees and a platform to expand and grow the brands through new development and conversions.

Analysts say Fairmont deal good for IHG

Intercontinental Hotels Group (IHG) is reportedly eyeing a bid for luxury hotel chain Fairmont, which Morgan Stanley investors say would be a good move for the group.

It was reported in June that owners of FRHI Hotels & Resorts, which include a Qatari government fund (Katara Hospitality) and Saudi Prince Alwaleed bin Talal's Kingdom Holding Company, are looking to sell the luxury operator.

Yesterday, Morgan Stanley analyst told UK newspaper *The Guardian*: "Press reports (Sunday Times) suggest that InterContinental is closing in on a deal to buy Fairmont Raffles for £1.9bn. Sources suggest InterContinental has beaten rivals including Wyndham and Accor, and is likely to seal the deal 'within weeks'.

"Neither party has commented, but we note that InterContinental has not put out a statement denying the rumour, as it did after the Starwood takeover rumour (though the company said it was required by the authorities to put out a statement that time).

Deutsche Bank and Morgan Stanley were hired to market the Toronto-based company, whose brands comprise Fairmont, Raffles and Swissotel.

Morgan Stanley told *The Guardian* that such a deal would be good for IHG, as the group is weaker in the luxury market.

FRHI operates 116 hotels with nearly 44,000 rooms in 34 countries. The list includes some historic luxury properties like New York's Plaza Hotel, the Peace Hotel in Shanghai and the Savoy in London.

One hotel executive estimated that FRHI could fetch up to $3 billion for the sale of the company.

IHG had been in discussions with Starwood Hotels over a possible multibillion-dollar merger, according to the report the Sunday Times, but regulatory issues meant "talks never got off the ground", a senior City source said.

IHG, which owns the Holiday Inn and Crowne Plaza brands, is said to be looking at investment in other hotel groups, including FRHI Hotels & Resorts and Swiss-based hotel management firm Mövenpick. A decision on whether to make a bid for either group has not yet been made, with Asian sovereign wealth funds also said to be interested

Group statement of cash flows

For the year ended 31 December 2014	Note	2014 $m	2013 $m	2012 $m
Profit for the year		**392**	374	538
Adjustments for:				
Net financial expenses		**80**	73	54
Income tax charge	7	**208**	226	9
Depreciation and amortisation		**96**	85	94
Impairment reversal	5	**–**	–	(23)
Other exceptional operating items		**(29)**	(5)	27
Equity-settled share-based cost	26	**21**	22	22
Dividends from associates and joint ventures	14	**2**	5	1
Other items		**4**	2	(3)
Operating cash flow before movements in working capital		**774**	782	719
Increase in trade and other receivables		**(18)**	(9)	(50)
Net change in loyalty programme liability and System Fund surplus	32	**58**	61	57
Increase in other trade and other payables		**61**	8	26
Utilisation of provisions	19	**(2)**	(3)	(12)
Retirement benefit contributions, net of costs		**(6)**	(18)	(95)
Cash flows relating to exceptional operating items		**(114)**	(33)	(6)
Cash flow from operations		**753**	788	639
Interest paid		**(76)**	(74)	(50)
Interest received		**2**	2	2
Tax paid on operating activities	7	**(136)**	(92)	(119)
Net cash from operating activities		**543**	624	472
Cash flow from investing activities				
Purchase of property, plant and equipment		**(84)**	(159)	(44)
Purchase of intangible assets		**(162)**	(86)	(84)
Investment in other financial assets		**(5)**	(154)	(2)
Investment in associates and joint ventures		**(15)**	(10)	(3)
Loan advances to associates and joint ventures		**(3)**	–	–
Capitalised interest paid		**(2)**	–	–
Disposal of hotel assets, net of costs	11	**345**	460	4
Proceeds from other financial assets		**49**	109	4
Distribution from associate on sale of hotel		**–**	17	–
Proceeds from other associates and joint ventures		**–**	3	–
Tax paid on disposals	7	**–**	(5)	(3)
Net cash from investing activities		**123**	175	(128)
Cash flow from financing activities				
Proceeds from the issue of share capital		**–**	5	10
Purchase of own shares		**(110)**	(283)	(107)
Purchase of own shares by employee share trusts		**(68)**	(44)	(84)
Dividends paid to shareholders	8	**(942)**	(533)	(679)
Dividend paid to non-controlling interests		**(1)**	(1)	–
Transaction costs relating to shareholder returns		**(1)**	–	(2)
Issue of long-term bonds		**–**	–	632
Increase/(decrease) in other borrowings		**382**	(1)	(99)
Close-out of currency swaps		**4**	–	–
Net cash from financing activities		**(736)**	(857)	(329)
Net movement in cash and cash equivalents in the year		**(70)**	(58)	15
Cash and cash equivalents at beginning of the year	17	**134**	195	182
Exchange rate effects		**(9)**	(3)	(2)
Cash and cash equivalents at end of the year	17	**55**	134	195

Group Financial Statements

Group income statement

For the year ended 31 December 2014	Note	2014 Before exceptional items $m	2014 Exceptional items (note 5) $m	2014 Total $m	2013 Before exceptional items $m	2013 Exceptional items (note 5) $m	2013 Total $m	2012 Before exceptional items $m	2012 Exceptional items (note 5) $m	2012 Total $m
Revenue	2	1,858	–	1,858	1,903	–	1,903	1,835	–	1,835
Cost of sales		(741)	–	(741)	(784)	–	(784)	(772)	–	(772)
Administrative expenses		(382)	(101)	(483)	(374)	(167)	(541)	(372)	(16)	(388)
Share of (losses)/profits of associates and joint ventures	3	(4)	–	(4)	2	6	8	3	–	3
Other operating income and expenses		16	130	146	6	166	172	5	(11)	(6)
		747	29	776	753	5	758	699	(27)	672
Depreciation and amortisation	2	(96)	–	(96)	(85)	–	(85)	(94)	–	(94)
Impairment reversal	2	–	–	–	–	–	–	–	23	23
Operating profit	2	651	29	680	668	5	673	605	(4)	601
Financial income	6	3	–	3	5	–	5	3	–	3
Financial expenses	6	(83)	–	(83)	(78)	–	(78)	(57)	–	(57)
Profit before tax		571	29	600	595	5	600	551	(4)	547
Tax	7	(179)	(29)	(208)	(175)	(51)	(226)	(151)	142	(9)
Profit for the year from continuing operations		392	–	392	420	(46)	374	400	138	538
Attributable to:										
Equity holders of the parent		391	–	391	418	(46)	372	399	138	537
Non-controlling interest		1	–	1	2	–	2	1	–	1
		392	–	392	420	(46)	374	400	138	538
Earnings per ordinary share	9									
Continuing and total operations:										
Basic				158.3¢			140.9¢			187.1¢
Diluted				156.4¢			139.3¢			183.9¢