Copenhagen Business School 2016 – Master Thesis: MSc Applied Economics and Finance

Hypothetical

Leveraged Buyout Valuation

- Examination of the leveraged buyout transaction process illustrated and applied in a practical context

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0 Executive Summary

This study aims at providing a comprehensive examination of the leveraged buyout (LBO) transaction process. We assess the theoretical foundations and characteristics of an LBO, thereby portraying activities in the acquisition stage, holding stage and the divestment stage of the LBO.

In the acquisition stage, typical characteristics of LBO targets are determined. These characteristics include stable and predictable cash flows, hard assets and low capex requirements. Furthermore, the composition of debt and equity in structuring the deal is addressed. In the holding stage, primary value creating activities in LBOs are examined, including financial, operational and governance engineering. Subsequently, main risks concerning LBO transactions are explained. Finally, in the divestment stage common return measures, e.g. IRR, are explained and exit strategies including IPOs and M&As are outlined.

The thesis employs a case study methodology to illustrate how an LBO could be designed in a practical context. In doing so, we apply our theoretical framework to generate a list of the most suitable LBO candidates on the Nasdaq OMX Stockholm Stock Exchange, our assumed universe.
We identify nine potential LBO targets and select Rezidor Hotel Group as our research company due to its attractive valuation, stable cash flow generation and efficiency enhancing opportunities.

We further undertake a financial and strategic analysis of Rezidor, which constitutes the base for the formulation of a business plan meant to improve profitability. We establish a hypothetical deal structure composed of 64% debt and 36% equity taking Rezidor's debt capacity, the current trends in European LBOs and the prevailing state on the debt capital markets into account. We project free cash flows and accumulated debt repayments over a holding period of five years for the purpose of estimating Rezidor's equity value at exit. We determine the hypothetical IRR from the LBO to 21% in a conservative base case. In a scenario with more optimistic assumptions, an IRR in the region of 32% appears feasible. Finally, we address the monetization strategy for Rezidor by considering the route of an IPO or in the event of a sale to a strategic buyer.

Thereby the thesis concludes that by selecting an LBO target based on a range of academically derived parameters and implementing typical value enhancing strategies, an IRR above 20% could realistically be achieved.

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1 Section – Introduction

During the late 1980's a new type of transaction appeared on the European market for corporate takeovers. Unlike regular mergers or acquisitions, this type of deal was financed by a substantial portion of borrowed funds and was therefore known as a leveraged buyout (LBO). In fact in 1988, the average LBO-transaction was financed by 90.3% debt. The architects behind such deals were managers of the newly founded private equity firms, who saw an opportunity to buy companies with undervalued assets, carving them up and selling them off bit by bit to a higher combined value. (Olsen, 2003) Such transactions created controversy in media and LBOs soon became synonymous to terms such as "asset stripping" and "corporate raids". However, today's leveraged buyouts have a more long-term approach, using the expertise of the private equity companies to build value and improve profitability. The perception of private equities has thereby changed; they now make the headlines as being successful turnarounds of companies, rather than destroyers of them.

The long-term perspective adopted by private equity firms has also resulted in the LBO-process becoming increasingly strategic. Compared to the 1980's, where the primary focus was to find companies with undervalued assets, private equities are today concerned with aspects such as market expansions, brand repositioning, improvements of operations, optimizing the corporate governance and outlining a lucrative exit strategy. As a result of LBOs becoming more complex, expectations are higher on today's LBO architects, but on the other hand, their job description has become much more interesting. In this thesis, we aim to explore the role of a LBO architect, identifying a suitable LBO target company and designing the value enhancing activities in an illustrative transaction, from start to end.

1.1 Problem Statement

Our aim with this master thesis is to examine the primary aspects of a leveraged buyout transaction and derive how they impact returns. Adopting the role of a private equity firm, we will start with a selection process to find the most suitable target for a successful LBO. Our intention is then to describe and implement the activities that are typical in an LBO transaction process. This thesis will therefore serve as a practical example of how a LBO transaction is executed, from start to finish. Ending with an exit strategy for our hypothetical LBO investment, we will determine a reasonable selling price for the company and by extension determining the return of the investment. The level of return is what is most important for any investor and will also be central in our problem statement:

What are the primary activities undertaken in leveraged buyouts and how do they impact the exit value and IRR in a hypothetical transaction?

1.2 Limitations

We are taking the role of a private equity firm, conducting a leveraged buyout (LBO) transaction. An LBO is the acquisition of another company using large amounts of debt to pay for the transaction. By choosing this orientation will limit the scope of our analysis in the following regards: Due to the very nature of private equity and leveraged buyout valuations, where a company's ability to take on and repay large amounts of debt is emphasised, less focus has been allocated on other valuation techniques. For instance, topics such as deriving an appropriate weighted average cost of capital will not be covered in this thesis, as it does not form part of the leveraged buyout valuation procedure.

To guarantee a fair assessment in the valuation of our target company, we have not considered any industry – or company specific information beyond the date of April 21st, 2016, which was our assumed date of acquisition. With regard to our established holding period we have limited our forecast to a period of five years into the future. In addition to the rationale behind our selected holding period from a PE fund perspective, we believe it would be too arbitrary to anticipate a longer time horizon in the context of an LBO, when considering that the market is changing fast.

We have chosen not to address the explicit fee structure of PE funds in greater detail. The reason for this is that we intended to examine the gross IRR rather than the IRR net of transaction fees. Thereby, as the fee structures in PE funds are complex and hard to approximate without first-hand information, it falls outside the scope of this thesis and our problem statement. The thesis is also limited in the sense that we have assumed that the reader is familiar with the elementary financial theories as well as the subject of corporate finance.

1.3 Contribution to Literature

After having investigated past master theses, we identified a substantial gap in the subject of private equity and leveraged buyouts. We could only find three related preceding theses – all of which are almost exclusively focusing on determining a value for a chosen company by applying the LBO-model. While this will also constitute a part of our thesis, we further aim at providing a full picture of how leveraged buyout transactions are structured. This entails starting with an illustration of the process when private equity firms select their LBO targets and ending with addressing considerations involved in the monetization of the investments.

By adopting this approach we have covered important aspects of the leveraged buyout transaction, which has not been considered in previous research. The selection process alone is a part of this thesis that we believe is unique and contributes to current literature. Having researched academic literature and identified key characteristics of suitable LBO target companies, we were able to construct a set of criteria that we used to identify the most attractive publicly listed company in Sweden for being a subject to a leveraged buyout. In addition, we have applied practical methods, commonly used in the financial industry, when determining key assumptions. For instance, for the purpose of deriving an appropriate cost of debt, we assessed our target company's creditworthiness using a framework developed by the credit rating institute Moody's.

The final stage of our hypothetical LBO transaction, the divestment stage, contains another aspect that we believe is a distinctive feature of our study compared to our predecessors. While earlier LBO-related theses concluded by projecting a value of their targets and IRR from their LBOs, we have additionally chosen to examine the exit possibilities of our LBO target company. Furthermore, preceding LBO studies have ignored aspects that contribute to the academic approach of writing a master thesis. For example, a comprehensive methodology section which is meant to portray previous research and to describe the conducted applied research approach is often ignored. As it is clearly stated in the learning objectives, we intend to comply with CBS' recommendations and provide a detailed description of the methodology of this study.

Finally, as both authors of this thesis have a profound interest in corporate finance in general and private equity in particular, we decided that we with this thesis would attempt to carry out a leveraged buyout transaction, as if we would work for a private equity firm. We therefore believe that this thesis can be of value for those who are interested in pursuing their careers within investment banking or private equity.

1.4 Structure of Thesis

The structure of this thesis is organized as follows: Section 2 explains and justifies the chosen methodology and section 3 presents the theoretical framework. Section 4 covers the screening of companies in order to find the most suitable target company, subject to an LBO transaction. Section 4 also contains a description of the identified target company and its industry. Section 5 continues to investigate the target company's market position in a strategic analysis, and is followed by a financial analysis in section 6. On the basis of the strategic and financial analysis, we devote section 7 to describing our plan for how we create value in our selected target company. Findings of section 5, 6 and 7 are used to projecting the future income statement and balance sheet in section 8. Finally, section 9 covers the leveraged buyout valuation and is followed by a discussion and conclusion in section 10.

2 Section – Methodology

This master thesis aims at examining the complete leveraged buyout acquisition process from the selection to the sale of a target company. In order to implement such a process, large amounts of information have to be collected and presented, allowing management to translate the knowledge into tactics and strategies. (Zikmund, 2000, p. 4) We are in this thesis taking on the role as both the business researcher and the decision-maker, carrying out a hypothetical, but realistic acquisition, amelioration and exit. Research undertaken to make a specific business decision, or as in our case, a number of interrelated business decisions, is called applied research. In contrast, basic research does not deal with specific business decisions, but aims instead at verifying the relevancy of a particular theory or to expand the knowledge about a certain concept. (Ibid, p.5) Since we are approaching a practical and specific problem, rather than a theoretical concept, the type of research we are carrying out is therefore an applied research.

2.1 Research Process

In this study, we choose to apply a modified version[1] of Zigmund's (2000) research process, to describe the procedure of how we get from the problem definition to the conclusion. This process is displayed in exhibit 1 below. As our problem statement has already been defined in section 1.1, we now turn our attention to the next activity in the research process, which is planning a research design.

Exhibit 1. Research Process

Source: Zigmund's (2000), Own creation

[1] We are deliberately excluding the third step named "Sampling", because it does not fit in to our approach of conducting an applied research. According to Zigmund (2000), "sampling involves any procedure that uses a small number of items or parts of the population to make a conclusion regarding the whole population." For the purpose of carrying out the LBO-transaction, we have no need of collecting subsets from a larger population, on the contrary we need access various data bases covering entire populations.

2.1.1 Planning a Research Design

"A research design provides a framework for the collection and analysis of data." (Bryman & bell, 2011, p. 40) The type of research design in this thesis is a case study design, which is the analysis of a problem concerning an isolated entity. (ibid, p.60) The case study design fits well into the objective of providing a practical example of how an LBO transaction process is carried out. Nonetheless, it is also worth mentioning that most of the activities that are described in the process could be applied on most other LBO-target companies.

2.1.2 Collection of Information

2.1.2.1 Collection of Literature

We began our thesis by searching for text books and academic articles about private equity firms and how they carry out typical leveraged buyout transactions. We found the most comprehensive and detailed descriptions of LBOs in Rosenbaum & Pearl's book from 2009. Other text books that were important for us in portraying how private equity firms undertake LBO transactions, were Pignataro (2013), DePamphilis (2015) and Gaughan (2011).

Having gained a good understanding about private equity firms and the leveraged buyout transaction process, we started searching for academic articles, that would specialise on certain parts of the process. Our predominant database for articles dealing with LBOs and private equity firms was EBSCO, however we also used J-Stor, Science Direct and Wiley to a certain extent.

After having identified our target company, our next step was to look for literature and information about the company and its industry. First, we read about the company in secondary sources such as news articles and equity research reports, but also in primary sources, such as annual reports, press releases and company presentations. Thereafter, we expanded our knowledge of the company by retrieving information about the industry that the company operates in and the company's main competitors.

We believe that our approach to the literature collection has resulted in the gathering of strong theoretical and practical sources, due to the following reasons: The relevancy of each source was initially assessed by the proximity to our subject. We have also carefully assessed each source's reputation by searching for related articles quoting the source of interest. One last aspect that we have considered with each source is the year of its publication. We believe that the novelty of information is important for drawing conclusions about the future prospects of our target company and its industry.

2.1.2.2 *Collection of Data*

As all of our conclusions are supported by facts and most often by industry – and company – specific data, access to reliable primary data has been of high importance for this thesis. We have therefore been very careful at assessing the different providers of data and also been consistent in using the same provider for making comparisons.

The first data base used in this study, for the purpose of screening our target company, was the Swedish equity research provider named börsdata.se. Once we had selected our target company, our attention was directed towards the target company itself and the industry in which it operates, which is the hotel industry. We soon realized that access to STR Global, the most widely used data base of the hotel industry, would be pivotal for being able to carry out a careful analysis. For that reason, we contacted STR Global and we managed to get access to a very detailed data set. We have also used data stemming from STR Global's competitors, namely MKG and HVS for other industry-specific information. Macroeconomic data such as GDP growth rates and forecasts have been gathered from the homepage of the International Monetary Fund, IMF. Data measuring the development of tourism in different regions in the world was collected from the annually published" UNWTO Tourism Highlights". UNWTO is "the United Nation's agency responsible for the promotion of tourism."

While these sources of data have been essential for analysing the hotel industry, we also needed to retrieve various company-specific data. In this respect, we have used Bloomberg, which in its data base has gathered uniform performance metrics (namely RevPAR, OCC and ADR) on all peer companies of our target. Bloomberg collects this data from each company's annual reports, which we in turn have spot-checked and found to be trustworthy. Moreover, for the purpose of finding information about historical LBO-transactions we used the databases Capital IQ and www.mergermarket.com, which provides financial information about mergers and acquisitions. Finally, for information about the development of initial public offerings, we used data provided by Thomson Reuters. As these databases are used in academic research and in industry practise we find no reason to question the reliability of the data.

2.1.3 Analysis

Analysis refers to the identification of "consistent patterns and summarizing appropriate details". (Zikmund, 2000, p. 66) We intend to describe such patterns of both our target company and its industry in section 5 Strategic Analysis and section 6 Financial Analysis. Some of the patterns will be illustrated by data tables or graphical illustrations. Next, we will use the analyses of section 5 and 6 to formulate measures of improvement in section 7. Section 8, "Forecasting", estimates the future cash flows of our target company and will also entail aspects of the analyses in section 5 and 6. We do however acknowledge that our analyses and forecasts are subject to uncertainty, which is why we conduct a sensitivity analysis in section 9 to analyse the impact certain deviations could have on our calculations.

2.1.4 Conclusion

The last part of the research process is to discuss our findings, serving as a basis for a conclusion addressing our problem statement. Zikmund (2000) highlights the necessity that such conclusions are effectively communicated, in order to achieve the highest impact. (ibid, p. 66) Consequently, we are presenting our conclusion at the very beginning of the thesis, namely in the executive summary, as well as in the very end, in section 10 "Conclusion".

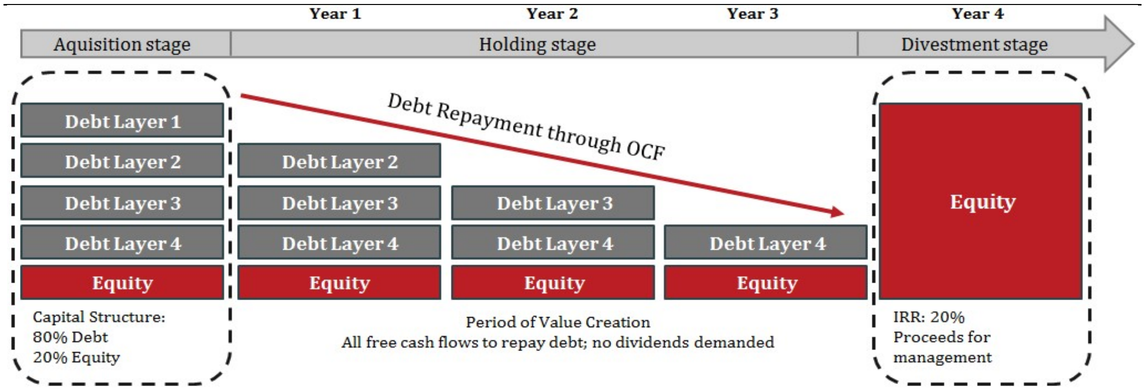
3 Section – Theoretical Framework

This section provides an introduction to private equity and leveraged buyouts. Key aspects of a successful leveraged buyout transaction will be presented as well as a description of the primary value creating mechanics. Subsequently, risk involved in leveraged buyout transactions and the structure of a typical deal will be outlined. Last, exit considerations and return measures will be addressed.

3.1 The Leveraged Buyout Concept

As the term suggest, a leverage buyout (LBO) is the acquisition of a company, using a significant amount of debt to pay most of the purchase price. The remaining part is equity and is usually provided by the acquirer, also called the financial sponsor, typically a private equity (PE) firm. Accordingly, this financing technique permits the sponsor to make large acquisitions without having to commit to a lot of equity capital. The idea is to use the cash flows generated by the acquired company to pay down both interest and debt. It is the reduction of debt and increase in equity over the holding period that reflects the value that is created to the PE firm in the LBO. The ultimate goal of the PE firm is to exit within a predefined timeframe, making annualized returns, according to Rosenbaum & Pearl (2009, p.161), above 20%. The concept of an LBO is illustrated in exhibit 2 below.

Exhibit 2. The LBO Concept



Source: Strandberg (2010), Own creation

Generally, an LBO transaction falls into three stages: the acquisition stage, the holding stage and the divestment stage (Oliveira, 2013): During the acquisition stage, a PE firm first screens the market for potential investment opportunities that satisfy their criteria for desirable target characteristics, a process that we will be described and discussed in section 4.1. Once an appropriate target has been identified, the PE firm initiates the due diligence process of the target, which involves a valuation and the formulation of a business plan for the LBO candidate. The business plan is meant to outline the possibilities for value creation that are expected to be realized in the subsequent holding stage. Last in the acquisition stage, the financial sponsor prepares a detailed structuring of the transaction and organizes the required leverage. In the following holding stage, the PE firm plays an active role in the reshaping of the company and its strategy, implementing operational as well as organizational changes. These changes are meant to generate improved earnings that will be used to pay down the debt (Berg & Gottschalg, 2005). The activities undertaken by the PE firm in the holding stage will be covered more in depth in section 3.3 “Value creation in the LBO”. By the end of the predefined investment horizon, the PE firm evaluates its possibilities to exit and the LBO transaction enters the divestment stage. The different exit options available to PE firms are described in section 3.6 “Exit Opportunities”.

3.2 Characteristics of a Strong LBO Candidate

There are many factors that contribute to the success of LBOs – one crucial factor is the choice of the right candidate, which is why the selection is of vital importance. The general view of LBO companies that make good LBO targets are firms having favorable market positions in attractive and non-cyclical industries, a prerequisite for the target to generate the stable and growing earnings, which in turn is necessary to pay down the debt. Other suitable characteristics that PE firms screen for are the following:

Stable and Predictable Cash Flows: Stable and predictable cash flows is by most authors described as the primary characteristic that the PE firms are looking for in their screening process. As argued in section 3.1, in LBOs PE firms aim to pay back its loans after some years. In order to do so, PE firms usually look for targets that generate positive and stable cash flows in excess of what is necessary to cover its current operations and to pay its debt requirements. Therefore, suitable targets usually have low exposure to seasonal fluctuations in cash flows, as well as low sensitivity to macroeconomic factors. Hence, an ideal target should for example be relatively immune to economic downturns and fluctuating commodity prices. (Gaughan, 2011, p. 310)

Attractive Purchase Price: A strong factor for succeeding with an LBO transaction is to pay a low purchase price. This is due as paying a low purchase price does, all else equal, significantly impact the potential IRR that an investment can yield. Moreover, not overpaying for the acquisition is essential for the PE firm's ability to meet its debt obligations and by extension avoiding financial distress and bankruptcy. (DePamphilis, 2015, p.475)

Hard Assets: Since LBOs are relying on a very high proportion of debt, it is favorable if the target possesses plentiful, valuable and liquid tangible assets, which serve as collaterals to the debt. Attractive hard assets may for example be plant and equipment, inventory, receivables, real estates and cash – the more available, the cheaper the leverage becomes. (DePamphilis, 2015, p.468)

Low Capex Requirements: Closely related to the assets of the target are the capital expenditures. While it is an advantage for a capital intensive LBO candidate to have a strong asset base that can be pledged as collateral for the loans, it may simultaneously be a disadvantage for the firm's ability to repay the loans. Asset-heavy companies often have high additional capex requirements, due to the need of maintaining and replacing existing assets. Such businesses consistently having high levels of capital expenditure are unwelcome for sponsors, as they consume cash that could otherwise go toward paying interest payments, principal debt payments or dividends to the equity holders. (Rosenbaum & Pearl, 2009, p. 170)

Efficiency Enhancement Opportunities: Although PE firms look for candidates with strong underlying business models that will generate stable cash flows, it makes the target only more attractive it there is room for further enhancements, preferably within areas of expertise of the PE firm. Examples include cost-cutting measures such as spinning off underperforming business divisions, sourcing better terms with suppliers and customers, lowering corporate overhead, just to name a few examples (Gaughan, 2011, p. 319). The PE firm may also look for new revenue generating opportunities such as optimizing the pricing of products, diversifying the customer base or entering new markets (Rosenbaum & Pearl, 2009, p. 170).

Attractive Industry: Related to the given necessity of stable and recurring cash flows comes the setting of operating in an attractive industry. In the context of LBOs, an attractive industry is generally characterized by high economic and technological stability, as well as high degree of concentration. Typically, such markets have high entry barriers, low substitution possibilities and little dependence on customers and suppliers. A highly attractive industry would further be characterized by little exposure to the general economic sentiment and thus have a low degree of cyclicality. Ideally, such a market would also bear little exposure to regulatory risks. Last, when evaluating the attractiveness of an industry the potential exit alternatives should be an important consideration. As PE firms generally utilize all generated cash flows to service interest and principal repayments, investors will not get a return on their investment until it is divested. To have a clear exit strategy is therefore central when undertaking LBOs to ensure that returns will be realized. Monopolistic industries for instance are considered to be problematic as a result of the limited exit alternatives due to the high concentration. (Ernst & Joachim, 2012, p.188)

Experienced Management: A strong management team is vital to for succeeding with operational improvements as well as with the implementation of new strategies. If the LBO target does not initially possess the adequate management qualities, the PE firm must have a replacement ready before buying the company. (Gaughan, 2011, p.319)

Even though literature suggests that these are the characteristics that make companies good LBO targets, PE firms in practice sometimes deviating from these criteria. For instance, this may happen when they find that their in-house expertise could come to a great use for improving the earnings of the target company. There is more to gain for the PE firm if it successfully transforms the target company from being a loss-making firm into a profit-generating cash cow. Having that said, PE firms are very careful in the assessment of whether their internal knowhow is a good match with the specific target company, resulting in additional value creation. Examples of how PE firms create value in LBO transactions will be covered in the next section.

3.3 Value Creation in the LBO

PE firms typically apply three sets of value increasing actions, namely financial engineering, operational engineering and governance engineering. These actions are not necessarily mutually exclusive, but depending on the prior experiences and the expertise of the PE firm, it is likely to emphasize some of the actions more than others. Such prior experience has shown to be valuable to the portfolio company – a study by Acharya et al (2008) finds that the imposition of partners who worked as managers in the industry or as management consultants before joining the PE firm, has a positive and significant impact on the portfolio firm's ability to improve operations.

3.3.1 Financial Engineering

PE firms rely on financial engineering as a skill that is core to their investment strategy. Financial engineering refers to efforts to create value by improving a company's capital structure. Adding leverage reduces the taxable income of the portfolio company, thanks to the tax deductibility of interest. As a consequence, portfolio companies often pay little tax for five to seven years or longer following the buyout. In addition to the value created by the tax shield, PE firms continue to provide additional value to the portfolio company by sharing their financial expertise and network. In the deal structuring process, PE firms harness their extensive network in the financial industry to obtain the best possible terms for the loans. After the buyout, PE firms continue to manage negotiations on behalf of the portfolio company, in for instance negotiating short-term bank loans, bond underwritings, initial public offerings and subsequent stock sales. (Loos, 2005, p.23)

3.3.2 Operational Engineering

Operational engineering refers to the industry and operating expertise that PE firms use to improve the operating performance of their portfolio companies. There are many ways to enhance the operations of a company, but to maximize their potential of creating value; PE firms mostly invest in companies that operate in industries, in which private equities have prior experience. In cases where PE firms are not particularly experienced, they often hire outside expertise, either as consultants or as full time employees. (Kaplan & Strömberg, 2009, p.14)

Also, PE firms use their industry experience to formulate and execute a value creation plan. The value creation plan often involves specific cost-saving measures, such as reductions in corporate overheads and outsourcing of activities. Another area where costs are saved is within the investment activities of the portfolio company - more precisely its capital expenditures (Kaplan, 1989, p. 250). According to Kaplan (1989) capital expenditures are typically reduced gradually following the acquisition of a PE firm. This suggests that PE firms deliberately deteriorate the chances of long-term success for realizing short - and midterm returns.

Another aspect that belongs to the value creation plan is the positioning of the portfolio company. A common strategy imposed on portfolio companies is to focus on activities that constitute the company's core competencies. In such a focus strategy, any activity that is not part of the portfolio company's core business and performs worse than the competition is a potential subject for divestment. (Klier, 2009, p. 79) A study by Baker and Montgomery finds that 51% of the LBO transactions in their sample involved divestments, compared to conglomerate takeovers, where divestments happened once in every tenth transaction (Baker & Montgomery, 1994, p. 9). Contrary to focus strategies, it is not uncommon that PE companies have plans to pursue a so-called "buy and build" strategy. (Klier, 2009, p. 80) Such a strategy entails using the portfolio company as a platform for making further acquisitions that will create synergies, by bringing new customers, new markets or new technologies into the group.

3.3.3 Governance Engineering

There are several ways that LBOs reduce agency costs by motivating or disciplining management. First, a common practice of PE firms is to incentivize management in their portfolio companies. A variable pay consisting of stocks and options aligns the interests of the management with the owner and gives the manager the same fabulous upside potential as the PE firm. Not only is such an incentive scheme useful for motivating management, but also for retaining management over the entire investment horizon, considering that the stocks are worth most in the divestment stage and relatively illiquid during the holding stage. (Kaplan & Strömberg, 2009, p. 13)

Second, PE firms are known for being more actively monitoring their portfolio companies compared to owners of public companies. Cornelli & Karakas (2008) find significant evidence that board size and the number of outside directors of public companies decrease when being acquired through an LBO. Moreover, studies have shown that boards of portfolio companies meet more often and that they are more likely to replace management than boards of comparable public firms. (Kaplan & Strömberg, 2009) Third, the substantial leverage in portfolio companies leads to high interest expenses, which disciplines management, by pressuring the company to generate profits in order to pay the interest and principal of the loans. Failure to meet the debt obligations will not only leave the company bankrupt, but also management unemployed. For the same reason, management becomes less inclined to waste money at the expense of the owners - the PE firm. (Kaplan & Strömberg, 2009, p. 14)

3.4 Risks in LBO Deals

The risks of an LBO fall into two categories: Business risks and interest rate risks. (Gaughan, 2011, p. 320) Business risks refer to risks that leave the portfolio company with lower profits than anticipated, making it unable to support its debt obligations. One of the most important factors influencing a company's business risk is its operating leverage, which is the relationship between fixed and variable costs. (Damodaran, 1999)

Firms with large fractions of fixed costs have high break-even points, but show a greater potential of making large profits after having crossed the break-even point. Such firms are the same firms that enjoy substantial economies of scale, when increasing their production volumes. However, when sales volumes decline, the profits will decline faster than the decline in sales. Thus, operating leverage reaps large benefits in good times when sales grow, but significantly amplifies losses in bad times, resulting in a high business risk for a company. Firms can to some extent change their operating leverage by making its cost structure more flexible for changes. One example is to replace parts of the fixed salaries with variable salaries, aligning compensation with the company's financial performance. A second example is to outsource production, which is a measure that reduces the need for expensive plant and equipment and in turn eliminates fixed costs in the form of interest payments and depreciations.

Other important elements of business risk are uncertainty about supply and demand as well as uncertainty about output prices. Companies find it in general very difficult to reduce its exposure to these types of business risks, since they emerge from events taking place outside the organization. This is also the reason why highly cyclical companies are not considered to be good LBO candidates – simply because their future prospects are strongly correlated with the general economy, which is impossible to control for. Interest rate risk is the risk that the level of interest payments will change as a result of fluctuating interest rates. This is important to firms that have higher proportions of variable debt. For such companies, sudden increases in the interest rate can do great harm, especially in the first years when debt levels are still very high, as well as the regular interest payments. (Gaughan, 2011, p.320)

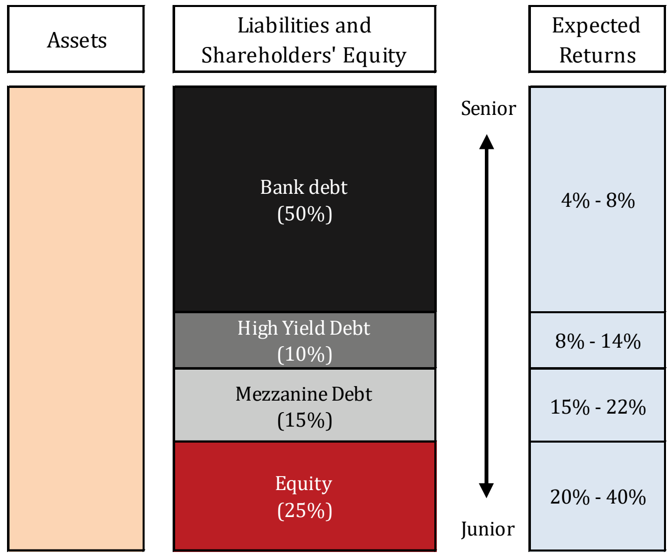
3.5 LBO Deal Structure

As previously stated, an LBO transaction involves the use of a lot of debt to finance the acquisition of the target. Most commonly, the debt is provided in different tranches, which are distinguished in terms of their securities, seniorities, maturities, coupons, and covenants. To make it easier to follow, we have illustrated the debt structure in exhibit 3.

The largest part of the debt in an LBO transaction comes as so called senior debt or bank debt. Senior debt represents the type of debt with the highest seniority since it is backed by assets of the company and often has a priority claim on the cash flow of the business. Assets that are generally considered to be sufficiently valuable and liquid to serve as collaterals include receivables, inventory, land, plant and equipment. (ibid, p. 317) In addition, senior debt often includes covenants that restrict the borrower from undertaking certain actions. Due to the high levels of security and seniority, senior debt has generally significantly lower interest rates compared to the other tranches. Senior debt typically consists of different tranches and structures with varying maturities, coupons and payment schemes. The most common tranches of senior debt include “amortizing term loans” which are repaid over the course of the LBO, “bullet loans” which are repaid at the end of the LBO and “revolver loan facilities” which only are used for operational purposes by ensuring a sufficient level of liquidity (Rosenbaum & Pearl, 2009, p.181-183). Amortizing term loans are usually referred to as term loan A (TLA) whereas bullet term loans are referred as term loan B (TLB). Due to its predefined payment scheme, TLA’s are often regarded as less risky compared to other loans without predefined payment schemes and are therefore commonly the lowest priced loans in the capital structure. Compared to TLA’s, TLB usually have a longer maturity, a higher price and a larger size in the capital structure. (Ibid, p.183)

High yield or subordinated debt makes typically up for only 10% of the total capital structure and is compared to senior debt much less secured. It therefore has considerably higher interest rates, compensating for the additional risk of defaulting on such debt. (Pignataro, 2013, p. 30) The next tranche, mezzanine debt, usually accounts for between 10% and 20% of the capital structure. As with high yield debt, these securities are expensive sources of finance, due to their lack of collaterals. Mezzanine debt is initially considered to be debt, but transforms into equity after a specific period of time. Equity, normally constituting 20 – 40% of the capital structure, is the part that is contributed by the PE firm. Equity is naturally the least senior tranche of the capital structure, meaning that equity shareholders are paid last during a liquidation of a company, after all other stakeholders.

Exhibit 3. Deal Structure of a Typical LBO



Source: Street of Walls (2013), Own creation

With regards to the organizational structure during the acquisition procedure, PE firms form several holding corporations which enable them to gain control benefits and tax advantages. The specific structure varies case by case and the complexity is usually driven by tax matters, as legislation governing taxation of returns to all stakeholders must be taken into consideration. (Yates & Hinchliffe, 2010, p.47-48)

In general, PE firms create a special purpose vehicle to perform the LBO. The special purpose vehicle is often referred to as "Newco" which is incorporated to raise the funds required to acquire the LBO target. Thus, the debt raised from lenders and the amount of equity contributed from the PE investors collates in the Newco, which then is used to acquire all outstanding shares of the target company. This is usually structured so that the target company then becomes a subsidiary of, or merges with the Newco.

Thereafter follows a procedure defined as push-down of debt meaning that the debt raise in Newco essentially is transferred downwards in the organizational structure to the target company. The reason for this is so that the lenders supplying the debt will have it closer to the target company's asset which will be generating cash flows to service the debt. The merger and debt-push down procedure is generally agreed on at the time of acquisition between the various financing parties. (ibid, p.49) (A typical Newco structure is displayed in Appendix A.)

3.6 Exit Opportunities

By the end of the holding period, ideally the PE firm has managed to reduce the target's debt-to-capital ratio and increased EBITDA, thus significantly growing the target's equity value. However, the financial returns from an LBO are not realized until the PE firm decides to cash in on their investment, typically through the following four options:

Strategic Sale: The target company is sold to a strategic buyer, often in the form of competitors that are motivated by creating synergies through the acquisition. These synergies are also the motivation behind the fact that the strategic buyer is often willing to pay a premium for the target. (Rosenbaum & Pearl, 2009, p.177)

Secondary buyout: This exit option refers to selling the target to another PE firm, willing to adopt a new focus, that can help taking the firm to the next level. This option has become increasingly prevalent, thanks to low interest rates and more capital invested in PE firms. (ibid, p.177)

Initial public offering (IPO): An IPO occurs when the target is offered to the public. This is an attractive exit option in booming market conditions, but is significantly more vulnerable to changes in the economic sentiment compared to outright sales. It is common that the PE firm chooses to retain large ownership stakes, with the plan to undertake a full exit in future. IPOs are usually very expensive, involving management fees up to 7% of the selling price and the stocks are most often sold at a discount at ca. 10%. (ibid, p.177)

Dividend Recapitalization: If the target company is not yet ready for a full exit, PE firms may achieve a partial exit from their investment through a special dividend issued. Leveraged dividend recapitalizations are often funded by adding debt to the target's existing capital structure. (ibid, p.177)

3.7 Return Measures

In order to assess the attractiveness of a potential LBO, PE firms primarily use the internal rate of return (IRR). (ibid, p.172) Thus, the IRR constitutes a key measure when it comes to analyse returns in LBO's. The IRR provides a measure of the total return a PE fund receives on its equity contribution over the course of the holding period. Moreover, IRR represent the discount rate for which the net present value of the investment would be zero. PE firms seek to earn superior returns, and historically an IRR threshold of 20% has been consider a typical in order for an acquisition to be deemed attractive. In the context of LBO's, the IRR can be defined as below.

(1)

$$\left(\frac{Equity\ Value_{Exit}}{Equity\ Value_{Entry}}\right)^{\frac{1}{Holding\ Period}} - 1$$

In addition to the IRR, cash return is another measure used to examine the return potential from an investment. Cash return represents the multiple of the PE funds equity contribution and the equity value at exit and is in contrast to the IRR not impacted by the time value of money. (ibid, p.171-172)

4 Section – Description of LBO Target

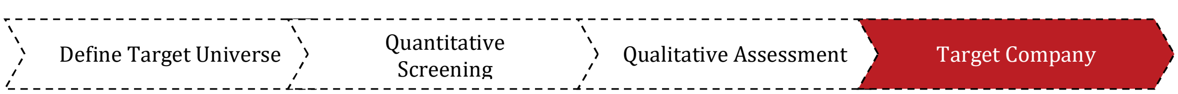
Having outlined the theoretical framework of an LBO transaction, we are now in a good position to use our acquired knowledge for conducting a hypothetical LBO transaction. As we know from section 3.1, a typical LBO transaction process starts with identifying a suitable candidate. This is also what the next two sections are intended for. Once we have identified our target company, we will devote the remainder of section 4 to learning more about the target company, its industry and its main competitors, which we hereinafter call "peer companies."

4.1 Target Selection Process

As a first step in our target selection process, we laid out a few assumptions and limitations regarding to the scope of the investment case. These assumptions and limitations permitted us to define a target universe, on which we applied a set of screening criteria, which was the second step in this process.

After having narrowed down the number of candidates to a manageable size, the last step in the selection process was to perform a qualitative assessment of the candidates that were left. The premises of the qualitative assessment were either pass or fail, where companies had to pass all evaluated factors to be considered a suitable LBO candidate. This process eventually generated our target company, which will be presented at the end of section 4.1.

Exhibit 4. Description of Target Selection Process



Source: Own creation

4.1.1 Defining the Target Universe

First, as we chose the perspective of a typical PE frim operating on the Swedish market, we limited our target universe to Swedish firms exclusively. Second, with regards to the scale of the acquisition, we assumed to operate a fund with a maximum size of SEK 20bn, as this is assumed normal within the Swedish PE context (EQT, 2016). For funds of such a magnitude, it is common practice in the industry to execute acquisitions ranging from c SEK 1bn to SEK 6bn (EQT, 2016) and we have thus assumed to hold an investment mandate of equal size.

Third, to facilitate the availability of information, we decided on limiting our target universe to exclusively include public companies. Fourth, in order to guarantee a certain level of credibility of information, we restricted our target universe to companies listed on the main Swedish stock exchange, Nasdaq OMX Stockholm. The purpose of this limitation was to reduce the possibility of having unreliable information in our analysis. Nasdaq OMX Stockholm, as opposed to smaller stock exchanges in Sweden, such as NGM and Aktietorget, are significantly stricter in their listing requirements and enforces a considerable higher level of legal standards among companies on its main list. (Nasdaq, 2015) Last as we are interested to implement operational changes on our target company, we choose to exclude purely financial companies, where such measures are difficult or even impossible to carry out, as they do not have any tangible operations. Hence, subject to the assumptions and limitations, the scope of the case beholds Swedish firms, listed on the main Nasdaq OMX Stockholm stock exchange, excluding property & financials and investment companies, and with a total market capitalisation ranging from SEK 1bn to SEK 6bn, summaries in exhibit 5.

Exhibit 5. Description of the Target Universe

Data Sample	
Target Screening Universe	**# Companies**
Initial Universe	**295**
OMX Large Cap	(+81)
OMX Mid Cap	(+109)
OMX Small Cap	(+105)
Adjustments	**-221**
SEK 1 bn < Market Capitalisation < SEK 6bn	(-201)
Property & Financials	(-12)
Investment Companies	(-8)
Ultimate Universe Subject to Screening	**74**

Source: Börsdata.se, Own creation

4.1.2 Quantitative Screening

In section 3.2 we described the most attractive characteristics of an LBO target that a PE firm looks for in its screening process. For the purpose of our screening process, we intended to apply the most common screening criteria, which is why we created a list that shows which criteria are most often mentioned in the existing literature. This list is presented below in exhibit 6. We realized that some of these criteria are less quantifiable. For instance, "competent & experienced management" and "attractive industry" are parameters that very difficult to quantify, which is why we apply a more qualitative approach on some of the characteristics in exhibit 6. The qualitative assessment will follow in the next section.

Exhibit 6. Literature Findings

Literature Review						
Criterias	**DePamphilis**	**Gaughan**	**Pignataro**	**Rosenbaum**	**Abdesselam**	**Klier**
Stable Cash Flows	✓	✓	✓	✓	✓	✓
Attractive Purchase Price	✓			✓	✓	✓
Attractive Industry	✓				✓	✓
Sufficient Debt Capacity	✓	✓		✓		✓
Room for Improvement		✓	✓	✓		
Experienced Management						
Low Capex Requirements	✓	✓		✓	✓	✓
Assets Adequate as Collaterals			✓	✓		

Source: DePamphilis (2015), Gaughan (2015), Pignataro (2013), Rosenbaum (2009), Abdesselam (2008), Klier (2008), Own creation

As we can see in exhibit 6, "stable cash flows" were the characteristic that were mentioned most frequently in the literature that we investigated. To incorporate such a variable in our screening, we chose to exclude companies that did not reach a minimum of 5% EBITDA[2] margin over the last 5 years. At the same time as we are interested in finding a company with stable recurrent cash flows, we also would like to find a company in which we can implement changes and boost profitability, satisfying the characteristic "room for improvement". Companies with high EBITDA margins are already very profitable and would presumably not have too much room for improvements. We quantified this by setting a maximum EBITDA margin of 20%.

The next characteristic that we could quantify was "an attractive purchase price". For the purpose of finding a potentially undervalued company, we used the enterprise value multiple of EBITDA, which is a ratio frequently used in valuations by the financial industry. (Rosenbaum & Pearl, 2009 p.44) Another aspect that is closely related to an attractive purchase price is the timing of the acquisition. In order to incorporate the aspect of timing, we included the last 12

[2] Earnings before interest, taxes, depreciation and amortisation.

month's share price development in our screening. We chose to define "attractive purchase price" as a company with an enterprise value multiple of EBITDA below 15.0x and a share price return below 30% over the last twelve months.

We thereafter defined "assets adequate as collateral" as intangible assets with a maximum share of 20% of total assets. As explained in section 3.5, the rationale behind this is that companies with a high level of tangible assets are better suited for being LBO candidates, since their tangible assets can be used as collaterals.

In order to capture a company's sufficient debt capacity, we excluded all companies with a Net Debt[3] multiple of EBITDA below 2.0x. This multiple is a good tool for this purpose because it takes into account a company's ability to decrease its debt – which is what an LBO target is intended to do. A rule of thumb is to be concerned with a firm having ratios higher than 5 or 6 because this means that it would take 5 to 6 years for the firm to pay off its debt burden if the net debt and EBITDA are held constant. Such a long payback period is definitely not desirable feature for a successful LBO transaction, where large amounts of debt are paid back fairly quickly. (Tan, 2014)

As a result of the application of the above-mentioned variables, our target universe, which initially consisted of 74 companies, was reduced to a number of 9. These companies are listed in exhibit 7 and will be further subject to a qualitative assessment.

Exhibit 7. Remaining Companies after Quantitative Screening

Quantitative Screening Results (Financials in SEKm, FY15 data)

Company	1 Year Share Price Return	Market Cap	Intangible Assets/ Total Assets	EBITDA Margin	EV/ EBITDA	Net Debt/ EBITDA
Rezidor	4.5%	5,941	14.0%	10.1%	6.0 x	-0.3 x
Nolato	4.4%	5,603	17.0%	15.6%	7.4 x	-0.2 x
Gränges	-1.4%	5,449	0.0%	13.7%	7.4 x	0.2 x
Fenix Outdoor	-9.3%	4,686	7.0%	9.9%	11.2 x	0.2 x
Haldex	-46.0%	3,072	17.0%	9.7%	7.3 x	0.7 x
OEM	22.3%	2,981	14.0%	12.2%	11.5 x	0.5 x
Bulten	-19.3%	1,547	10.0%	8.4%	7.7 x	0.8 x
Malmbergs	6.4%	1,256	1.0%	15.8%	11.4 x	-0.5 x
Swedol	12.1%	1,126	3.0%	5.7%	13.8 x	0.9 x

Source: Börsdata.se, Own creation

[3] Defined as interest bearing debt less interest bearing assets.

4.1.3 Qualitative Assessment

After having screened our sample with quantitative measures, we applied a more qualitative approach on the companies that remained. Similar to the quantitative screening, we based the qualitative assessment on the characteristics that we gathered from the literature. The first characteristic we looked at was "non-cyclicality". A good measure of the cyclical nature of a company and its industry is the beta. The firm-specific beta indicates if the returns from a company's share are more or less volatile compared to the market portfolio. A beta higher than 1 means that the firm is sensible to market movements. Similarly, a beta as measured by the industry indicates an industry's sensitivity to the overall economy. Both measures of betas, the firm-specific as well as the industry-specific are information, easy to find on the internet. We collected the firm-specific beta values from Yahoo Finance, whereas the industry-specific betas were taken from Damodaran's compilation of sector betas. Next, we ruled out the companies with the highest firm and industry-specific betas, leaving us with the following 4 companies: Malmbergs, Swedol, Fenix Outdoor and Rezidor.

We thereafter reasoned that "non-cyclicality" and "attractive industry" are characteristics that are interrelated. In the view of a PE firm, non-cyclical industries are attractive industries. We therefore believe that the industry-specific beta would serve as a good estimate also for the characteristic "attractive industry". Having already satisfied this criterion, we further analysed the industry attractiveness on the basis of the degree of concentration and the potential entry barriers (Berk & DeMarzo, 2013, p.458). This resulted in the exclusion of Malmbergs, as its industry is characterised by a high degree of private firms which would be difficult to analyse.

The next characteristic to assess was "low capex requirements". This was evaluated based on the capital intensity of the company's strategy and its impact on capex. A suitable measure for this is the capex as percentage of sales ratio, which shows a company's propensity to re-invest its revenues back into productive assets. Applying this ratio on the 3 remaining companies, we found that all have a similarly low ratio and as a consequence we decided that we would proceed with all of the 3 firms.

Last, we looked at the ownership structure of the three remaining companies. In this regard, we based our assessment on the likelihood that the shareholders would be willing to sell their shares. One of the remaining candidates soon distinguished themselves from the rest. The majority owner of the international hotel operator Rezidor had recently announced that it was undergoing a strategic review of its hotel business including the potential divestment of Rezidor

(Karmin, 2016). Because of this Rezidor appeared the most favourable candidate in terms of ownership structure vis-à-vis executing the LBO.

Exhibit 8. Qualitative assessment of LBO Candidates

Qualitative Assessment				
Company	**Non-Cyclicality**	**Low Capex Requirements**	**Attractive Industry**	**Ownership Structure**
Rezidor Hotel Group	✓	✓	✓	✓
Fenix Outdoor	✓	✓	✓	×
Swedol	✓	✓	✓	×
Malmbergs Elektriska	✓	✓	×	
Gränges	×			
Haldex	×			
OEM	×			
Bulten	×			
Nolato	×			

Source: Own creation

4.1.4 Defining the Target Company

Hence, as a result of the outlined target selection procedure, Rezidor Hotel Group (Rezidor) was selected as our research company. Rezidor is a Stockholm based international hotel operator managing hotels, brands and assets owned by third parties. A more thoroughly presentation of Rezidor follows next.

4.2 Historical Overview of Rezidor Hotel Group

Rezidor was founded by Scandinavian Airlines System (SAS), when it opened its first hotel in Copenhagen in 1960. The company was initially a regional hotel chain in Scandinavia but started its international expansion in 1980 by opening a hotel in Kuwait. (Rezidor, 2016a) In 1994, Rezidor signed a master franchise agreement with the American hotel operator Carlson Hotels, which enabled Rezidor to operate the Radisson brand, forming Radisson SAS Hotels & Resorts. The franchise agreement was subsequently expanded to cover the Country Inns & Suites, Park Inn and Regent brands in 2002. Carlson secured its first ownership stake in Rezidor in 2005 when it acquired 25% of the company. (Rezidor, 2016a). Throughout the initiation of the master franchise agreement, Rezidor experienced a period of dramatic growth, when expanding its hotel portfolio, by a compounded annual growth rate of ca 20% between 1994 and 2006.

2006, with the listing on the Stockholm Stock Exchange, Rezidor became a public company. SAS, the majority seller in the initial public offering (IPO), reduced its ownership share from 75% to 6.7% after the IPO. Carlson, who owned 25% of the company prior to the IPO increased its ownership to 35% and became the largest shareholder. Carlson subsequently acquired the remaining 6.7% of shares owned by SAS raising its ownership stake to 41.7%. In 2010, Carlson additionally expanded its ownership and was now in the possession of 50.1%. (Rezidor, 2016a)

Carlson and Rezidor initially relied on the franchise agreement which enabled Rezidor to operate the Radisson, Park Inn and Country Inns brands in the EMEA region (Europe, the Middle East and Africa). However, a few years after forming the initial franchise agreement, the companies launched a strategic partnership "Carlson Rezidor Hotel Group", to ensure further growth, expansion and revenue generation. (Rezidor, 2016a) At present, Rezidor is based in Stockholm and operates branded hotels across the EMEA region under a master franchise agreement with Carlson which runs until 2052.

4.3 Operational Overview

Rezidor manages a diversified portfolio, consisting of 4 brands, ranging from upper midscale to luxury. Its original portfolio included Radisson Blu and Park Inn by Radisson. Since 2014, the portfolio also contains the luxury brand Quorvus Collection and the upscale brand Radisson Red. All brands are licensed and developed by Rezidor under a master franchise agreement with Carlson, meaning that Rezidor does not own the respective brands itself but holds the exclusive right of operating the brands. At present, Rezidor has 355 hotels in operation and 102 under development and is present in 80 countries. The following sections are meant to give the reader a better understanding of Rezidor's business model, portfolio and geographic reach.

4.3.1 Business Model

The business model of a hotel company is commonly referred to its mix of franchised, managed, leased and owned hotels in its hotel portfolio. Rezidor pursues an "asset-light" strategy, which means that Rezidor does not own any of the hotels which they operate today. Instead, Rezidor's business model relies on the three remaining, which will be described below and illustrated in Exhibit 9.

Exhibit 9. Rezidor's Contract Agreements

Description of Different Types of Contract Agreements			
	Management contracts	**Franchise contracts**	**Lease contracts**
Brand and Marketing	Rezidor	Rezidor	Rezidor
Staffing	Hotel Owner	Hotel Owner	Rezidor
Financial Commitment by Rezidor	Very little	None	FFE
Revenue for Rezidor	• Base Fee • Incentive Fee • Marketing Fee • Reservation Fee	• Licensing Fee • Marketing Fee • Reservation Fee	• All Revenues
EBITDA Margin Low Scenario	40%	30%	1%
EBITDA Margin High Scenario	75%	57%	10%

Source: Rezidor (2015b), Own creation

Lease contracts: Leased contracts are long-term property rental agreements between Rezidor and the proprietor, where Rezidor leases and operates the hotel. This means that Rezidor is accountable for all the risks and rewards inherent in the operations, but also bears the responsibility for all costs associated with operating the hotel and is in exchange entitled for receiving the profit exclusively. Under lease agreements, revenues are primarily derived from room revenues along with food & drink sales in hotel restaurants, bars and banqueting. Main costs relate to the rent paid to the landlord and personnel costs. In particular, rent is composed of an underlying fixed rent in addition to a variable rent as a percentage of hotel revenues (Rezidor, 2015a). Also, Rezidor is responsible for investments in order to maintain furniture, fixtures and equipment (FFE) in good condition over the lease agreement.

Management Contracts: Management Contracts are agreements that permit an external party to operate their own hotel using Rezidor's brands. Thus, Rezidor does not operate the hotel itself but rather allocates operating control to a hotel owner that performs the necessary managerial functions in return for a fee. While Rezidor owns the brand, the business itself still belongs to the hotel owner, who is responsible for all investments and expenses of the hotel. In its role as the management company, Rezidor typically receives compensation in the form of base and incentive management fees. Base fees make up the bulk of the compensation, defined as a fixed percentage of gross revenue. Incentive fees are being paid to Rezidor for meeting specific benchmarks, typically related to the owner's yearly profit rather than revenue. In addition to this, Rezidor also receives marketing fees and reservation fees based on room revenues and number of reservations made. In contrast to leased contract arrangements, Rezidor is not responsible for investments related to maintenance of FFE nor the personnel costs. Instead, such responsibilities are carried out by the hotel proprietor. For Rezidor, this implies less volatile cash flows related to lower operational leverage as well as less capital-intensity in operations. (Rezidor, 2015a)

Franchise Contracts: Under a franchise contract, Rezidor in its role as a franchisor, authorises a franchisee to use its brand for a prescribed period of time. Under such an arrangement, Rezidor derives revenues from brand royalties and licensing fees based on the total room revenues. As with managed contract agreements, Rezidor also receives marketing and reservation fees, which depend on room revenues and reservations. Further fee-based revenues can also be entitled to Rezidor should the franchiser utilize different concepts and programmes associated with Rezidor's brand. Rezidor bears no responsibility in investing and maintaining FFE under a franchise agreement.

As can be seen in exhibit 10, most of Rezidor's hotels today are under management contract (53.2%), which has been the case for the last 5 years. Franchising and leasing have historically been just as common, but the company has in the recent years primarily grown by adding managed and franchised hotels to the portfolio, which is reflected in the declining share of leasing contracts. This is in fact an outspoken strategy of Rezidor, since franchise and management contracts are generating more stable cash flows and higher profit margins than leasing agreements, which can be seen in exhibit 9. According to Rezidor, lease agreements will in the future only be used where cash flows are expected to be secure, that is in prime locations in mature markets. (Rezidor, 2009a)

Exhibit 10. Contracts in Operation and under Development

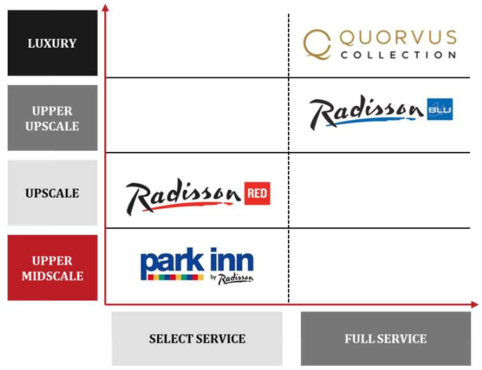
Rezidor Hotel Group						
Hotels by contract types	**2011**	**2012**	**2013**	**2014**	**2015**	**Pipeline**
Franchised	24%	25%	26%	26%	27%	14%
Managed	52%	53%	54%	54%	53%	86%
Leased	24%	23%	20%	21%	20%	0%

Source: Rezidor (2011a-2015a), Own creation

4.3.2 Brand Portfolio and Customer Segmentation

Rezidor manages a portfolio of four brands, each of which is targeting its own audience, ranging from customers in the upper mid-scale segment to the luxury segment, which can be seen in exhibit 11. Rezidor's most important type of customer is the business customer, accounting for 58% of all hotel stays. (Rezidor, 2015a) These customers pay more, demand less service and more recurring in nature as compared with leisure customers. With special "business class" offers, meeting room facilities and convenient locations, Rezidor's targets these customers primarily through Radisson Blu. The following paragraphs will describe Rezidor's brand portfolio more in detail.

Exhibit 11. Brand portfolio and positioning



Source: Rezidor (2015b), Own creation

4.3.2.1 Quorvus Collection

Quorvus Collection is Rezidor's rebranded luxury hotel chain, formerly known as Hotel Missoni. Its value proposition is meant to cater the younger luxury traveller, aged between 18 to 33. At present, the Quorvus Collection contains hotels in London, Edinburgh and Kuwait; all of them having an elegant design that sets the properties apart in their respective markets. Primary competitors of Quorvus Collection include The Leading Hotels of the World, Autograph Collection and The Luxury Collection. (Rezidor, 2014b)

4.3.2.2 Radisson Blu

Radisson Blu is Rezidor's most recognised and oldest brand, accounting for 66% of the total number of hotels in the portfolio and serving the upper upscale segment. The strong brand recognition is essential for Rezidor's strategy to grow in emerging markets, since it is appeals to high income earners and business travellers, who demand reliable hotel services, positioned in prime locations in major cities or airports. In this segment, Radisson Blu is the market leader in many markets, including Europe, Africa and the Middle East. The biggest competitors in this segment are Hilton, Marriott and Sheraton (Rezidor, 2014b). Partnerships with companies are an important driver for attracting customers to Radisson Blu hotels, especially in markets that are not known as typical tourist destinations.

4.3.2.3 Park Inn by Radisson

Park Inn by Radisson is together with Radisson Blu one of Rezidor's core brands and has belonged to the portfolio since 2000. Through a series of acquisitions and conversions, the chain has become Europe's 8th largest upper midscale brand.

With its modern and colourful design, Park Inn by Radisson targets families and young tourists who seek value for their money (Rezidor, 2011b). Main competitors include the French midscale hotel chains Mercure and Novotel, the Swedish side Scandic Hotels and the American chain Best Western. (Rezidor, 2014b)

4.3.2.4 Radisson Red

Radisson Red is the youngest of Rezidor's brands, launched in April 2016, and is positioned as a more daring and modern alternative to Radisson Blu. The hotel is meant to appeal the younger, design conscious and tech savvy travellers by incorporating digital apps, modern art and more common spaces. Its concierge app plays a central role for the hotel, replacing the reception desk as it can be used by guests as room keys and for check in and check out. Moreover, it allows guests to pay their bar tab and order room service. Radisson Red also provides free Wi-Fi and the ability to watch movies on room walls.
Currently, there is only one Radisson Red hotel open, but according to Rezidor, there are plans to open as many as 60 Radisson Red hotels in urban centres across the world by 2020. (Rezidor, 2016b) The primary competitive set for Radisson Red includes Aloft, Indigo, and Hyatt Place. (Rezidor, 2014b)

Exhibit 12. Brands in Operation and under Development

Rezidor Hotel Group						
Hotels by brand	**2011**	**2012**	**2013**	**2014**	**2015**	**Pipeline**
Radisson Blu	209	218	218	228	233	65
Park Inn by Radisson	109	112	114	107	116	35
Others	7	8	5	5	6	2
Total	**325**	**338**	**337**	**340**	**355**	**102**

Source: Rezidor (2011a-2015a), Own creation

4.3.3 Geographic Markets

With regards to Rezidor's geographic operations, its focus has historically been Europe and more specifically Western and Northern Europe. As we know from the previous section, Rezidor is still the very strong in Europe, being the market leader in the upper upscale segment, but focus has shifted to Eastern Europe and Russia, where most of Rezidor's growth has taken place. As can be seen in exhibit 13, Rezidor's two largest geographical markets are now Western Europe (excluding the Nordics) and Eastern Europe, representing 38% and 27% respectively. Another geographic focal point of Rezidor's growth strategy is Africa and the Middle East - markets in which Rezidor was present at an early stage with Radisson Blu. Despite the political unrest in large parts of the region, Rezidor has continued to expand its hotel portfolio by 9% per annum since 2010. (Rezidor, 2014c) Rezidor's strong belief in Africa and the Middle East is also reflected in Rezidor's portfolio of hotels under development, where the Middle East and Africa account for 60% of the pipeline. Of special interest in this region is Sub-Saharan Africa, where Rezidor for many years has been in possession of the largest pipeline of hotels under development in the industry. (Rezidor, 2012a-2015a) Many of these hotels are and have been funded by a group of Nordic Development Funds (NDF) in a project called "Afrinord", created in 2005. The partnership with Afrinord is important for Rezidor's expansion since it secures funding for the construction of the hotels and subsequently implies stable ownership. Andrew McLachlan, Rezidor's vice president in Africa, states that "Afrinord offers a strategic advantage few international operators can match. It helps overcome the funding hurdles which delay growth." (Rezidor, 2010b)

Exhibit 13. Number of Hotels by Region

Rezidor Hotel Group						
Hotels by Region	**2011**	**2012**	**2013**	**2014**	**2015**	**Pipeline**
Nordics	18%	17%	18%	18%	17%	2%
Rest of Western Europe	50%	48%	45%	42%	38%	13%
Eastern Europe	19%	21%	23%	25%	27%	25%
Middle East, Africa & Others	13%	14%	14%	15%	18%	60%

Source: Rezidor (2011a-2015a), Own creation

4.3.4 Club Carlson

Rezidor's consumer incentive program "Club Carlson" was launched in 2011 as a successor to the former program "goldpoints plus". The idea was to embrace all hotels, belonging to the Carlson Rezidor Hotel Group, which would amount to a total of 1,000 hotels. For Rezidor, this constitutes a clear advantage, rather than having a program on its own: The combined bonus program allows Rezidor to attract more guests from the US and Asia, at the same time improving the value proposition for its own customers in expanding the hotel coverage to other continents.

Judging by the growth in memberships, the relaunch has so far been a success. From 7.8 million members in early 2011 to 13.5 million members at the end of 2015, the Carlson Group has almost doubled the number of members in less than five years. In addition to the scope of more than 1,000 hotels the program also includes 20 airline companies, as well as 2 major car rental companies. As compared to competing loyalty programs, Club Carlson is among the most rewarding programs according to the leading market study conducted by J.D. Powers (2015).

4.4 Financial Overview

4.4.1 Rezidor's Financial Development

Reviewing the financial development of Rezidor, summarised in exhibit 14, the company appears solid in terms of revenue growth since its IPO in 2006. Over the course of its trading history, Rezidor has achieved to grow its revenues by a compounded annual growth rate (CAGR) of 3.8%. Over the last 5-year period Rezidor has had an average revenue growth of 4.9%. Considering Rezidor's profitability, as determined by operating income before interest, taxes and depreciation & amortization (EBITDA) margin, Rezidor has demonstrated efficiency in its profit generation activities as the EBITDA-margin has been positive for the entire 5-year period yielding an average of 7.2%. However, looking at the operating income (EBIT) margin, it has been lower however which implies promising trend during the last 3 years. Hence, with regards to the development in revenue and EBITDA, observed on a high-level basis, Rezidor appears to be stable and consistent in its cash flow generation.

Considering net debt[4], it is reasonable to conclude that Rezidor has maintained a fairly strong balance sheet over the longer term. Financial leverage[5], indicates that Rezidor has utilized a low level of interest-bearing debt in relation to earnings as the ratio has averaged -0.1x and never been above 0.5x over the period. A negative net debt to EBITDA ratio means that Rezidor has held more cash than interest-bearing debt on average between 2011 and 2015. When it comes to returning cash to shareholders, Rezidor has a dividend policy of distributing approximately one third of annual income after tax to its shareholders (Rezidor, 2015a).

In 2014, Rezidor completed a rights issue in order to improve its balance sheet partly by settling financial liabilities, whilst also to accelerate its restructuring process of terminating loss-bearing contracts and renegotiate terms for profit-bearing contracts. By doing so, Rezidor improved its operational efficiency and thus enhanced its ability to reach a higher level of profitability in the long-term. The rights issue was fully subscribed and contributed with SEK 544m (EUR 60m) to Rezidor's balance sheet before transaction costs. Rezidor's number of outstanding shares (NOSH) increased with approximately 18% as a result of the transaction. (Rezidor, 2014a)

[4] Defined as cash & cash equivalents plus short-term interest-bearing assets minus interest-bearing short and long-term financial liabilities (Rezidor, 2014a).
[5] Defined as net debt divided by EBITDA.

Exhibit 14. Financial Development

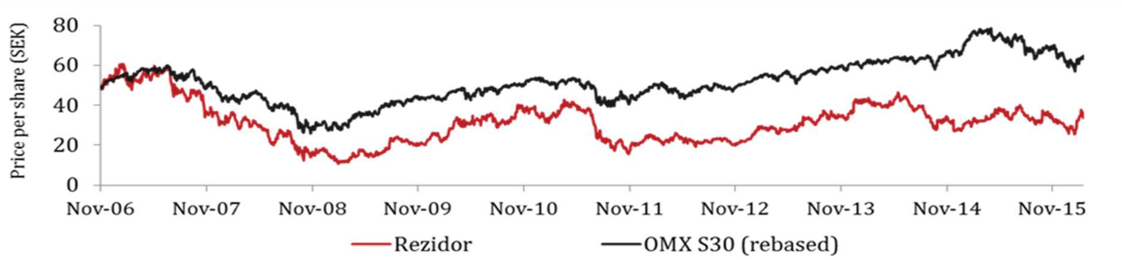
Rezidor's Financial Development						
As reported	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Revenue Growth	10.0%	6.9%	-0.5%	1.9%	6.4%	4.9%
EBITDA Margin	4.1%	5.5%	8.8%	7.6%	10.1%	7.2%
EBIT Margin	-0.9%	-0.1%	4.8%	3.3%	5.7%	2.6%
Net Debt/EBITDA	-0.1 x	0.3 x	0.1 x	-0.5 x	-0.4 x	-0.1 x
Equity Ratio	44.1%	39.8%	40.6%	51.3%	53.1%	45.8%
NOSH (m)	146.3	146.3	148.1	174.4	174.4	-

Source: Rezidor (2011a-2015a), Own creation

4.4.2 Share Price Performance

By looking at Rezidor's share price development in exhibit 15, one can observe that Rezidor's share price has a relatively high correlation with the market portfolio, also inferred by the beta relatively close to 1 during the whole period[6]. One can also observe that the stock has not generated any positive returns for shareholders who bought the stock at the IPO in 2006. As a matter of fact, Rezidor's share is down 30.5% since the initial public offering. The share price development has also been weak during the last 5 years. Rezidor's share is down 5.7%, while the market portfolio has made a return of 27.5% over the same horizon. The last 12 months, however, the share has generated a positive return of 6.3%, whereas OMXS30 has fallen by -14.7%.

Exhibit 15. Market & Rezidor Share Price Development November 2006- March 2016



	1 Year	3 Year	5 Year	Since IPO
Rezidor	6,3%	18,0%	-5,7%	-30,5%
OMXS30	-14,7%	16,4%	27,5%	28,2%
Beta	0,77	0,84	0,71	0,75

Source: Yahoo Finance, Own creation

4.4.3 Ownership Structure

As of the initial public offering in 2006, Rezidor has been part of the Nasdaq OMX Stockholm Mid Cap segment, offering only one share class. This means that there is no difference between Rezidor's voting and cash flow rights, implying that a 1% ownership simultaneously represents

[6] Beta was derived from regressing Rezidor's excess return against the market return for each period.

1% of the voting rights. Rezidor's largest owners, displayed in exhibit 16, include the majority owner Carlson along with a number of dispersed institutional owners that are mainly composed of banks and pension funds. Currently, Rezidor holds 2.1% of the shares outstanding as treasury shares within the company due to share repurchases made in the past. These shares can be used for management stock options programmes and incentive remunerations in the future. (Rezidor, 2015a)

Exhibit 16. Ownership Structure

Rezidor's Largest Shareholders		
Name	**# Shares**	**Ownership/Votes (%)**
The Carlson Group	87,552,187	50.2%
JP Morgan	6,971,940	4.0%
Fidelity Management & Research	5,376,051	3.1%
Handelsbanken Fonder	4,999,537	2.9%
Fjärde AP-fonden	4,200,150	2.4%
Norges Bank Investment Management	3,907,910	2.2%
AMF Aktiefond Sverige	3,742,233	2.2%
Rezidor Hotel Group	3,681,138	2.1%
Nordea	3,522,611	2.0%
Group SBB	3,291,649	1.9%

Source: Rezidor (2015), Own creation

4.4.3.1 Carlson Group

Rezidor's largest shareholder is Carlson Group and is at the same time the owner and franchisor of Rezidor's brands. Carlson was for decades operating in the stamp business until its founder Curt Carlson acquired its first Radisson Hotel in Minneapolis in 1962. In 1975, Carlson added T.G.I. Friday's to its brand portfolio, but it wasn't until the 1980's that Carlson's hotel business took off, as it founded Country Inn's & Suites By Carlson, which today makes up for the largest share of its hotel portfolio. In 2000, Carlson acquired the Park Plaza and Park Inn brands and is today the world's 10th largest hotel company. Carlson's relationship with Rezidor as described in section 4.3.

4.5 Industry Overview

4.5.1 The International Hotel Industry

The international hotel industry consists of about 15.5 million rooms and 160,000 hotels that can be divided into branded hotels and independent hotels. About 53% of all hotels worldwide belong today to hotel chains, which implies that the global hotel industry is still relatively fragmented. The more developed market of North America leads the world in branded hotel inventory, with 67%. However, in less mature markets, such as the Middle East & Africa, branded hotels are less established, only making up for 44% of the total number of hotels. Among all branded hotels, approximately 50% belong to one of the top six hotel companies, namely IHG, Hilton Worldwide, Marriott Hotels and Resorts, Wyndham Hotel Group and Choice. (Rezidor, 2014b)

4.5.1.1 Characteristics

As mentioned in the paragraph above, the hotel industry is a fragmented industry. Not only is there a large number of companies operating hotels, but there is also a wide number of individuals and corporations owning hotels, outsourcing their operation to hotel operators. Moreover, customers are fragmented, as they can be either companies or individuals. Customers can be of almost all age groups and be travelling for either business purposes or for leisure. Customers of the hotel industry are mostly end consumers and are consuming the service at the same place and time at which it is produced.

Furthermore, hotel services are intangible, which means that its quality is difficult to demonstrate or to be tested in advance. This means that hotel services are unique and as opposed to tangible products, hotel services are labelled as experiences. The intangible nature of hotel services implies that customers face uncertainty about the quality of the service prior to their stay. The aspect of thorough investigation is therefore important for price-conscious customers, reducing the uncertainty. Another way of reducing uncertainty is to choose a hotel operator that is known for consistently providing the expected quality. This is one of the major advantages of the international hotel chains. Research conducted by The Futures Company on behalf of IHG, shows that 71% of the respondents perceive international hotel brands as more consistent than local hotel brands. (IHG, 2013) One last distinct characteristic of the hotel industry is its cyclical relationship with the state of the global economy. This relationship will be described more in detail in the next section.

4.5.1.2 Hotel Demand

Demand for hotel services is primarily influenced by macroeconomic factors, such as the economic growth of a country or a region. High domestic economic growth often implies that its companies are performing well compared to its international competitors. High relative competitiveness fosters business travels, as more foreign companies have reason to come to the country to do business. Foreign economic development is also favourable for the domestic hotel industry, especially when neighbouring countries are becoming more prosperous. Such circumstances induce a higher willingness to pay for vacation abroad. Other macroeconomic drivers of demand for hotel services include population growth, growth of the disposable income, and the development of currency and interest rates. (Scandic, 2015b) Non-economic factors that affect demand for hotel services include demographics, access to airports and other means of transportation, cost of transportation and ultimately the freedom to travel.

Global demand for hotel accommodation was seriously affected by the crisis in 2009, which led to dropping occupancy rates and average room rates. As a result, total industry revenues declined by 12% from 447 billion dollars in 2008 to 395 million dollars in 2009. However, the industry was fairly quick to recover. In 2010, revenues were up with 6 billion and already in 2011; industry revenues surpassed the levels from before the crisis, amounting to 457 billion dollars. (Statista, 2015) Much of the recovery was achieved thanks to the growing number of tourists from emerging countries and their improved purchasing power. Another explanatory factor was naturally GDP growth and the return of business confidence that affected business travel positively. The last five years have been favorable for the international hotel industry. Total industry revenue has been growing at a steady rate with a compounded annual growth rate of 3.1%, driven by a growing number of tourist arrivals. (Statista, 2015)

4.5.1.3 Hotel Supply

The supply of new hotels is primarily affected by the prevailing levels of demand and responds accordingly. However, supply cannot change as fast as demand, because the addition of a new hotel requires a large investment and a several years of construction. Consequently, supply has therefore a time lag, which is determined by the time it takes to build new hotels, which is on average four years. (Runyan, 2004)

The supply of new hotels was particularly strong in the years before the financial crisis in 2009. This supply chock was driven by four years of strong demand between 2003 and 2007, which led to high occupancy rates and average daily room rates. As a result of the financial crisis, travel budgets were cut both among companies and individuals, which caused a steep decline in hotel demand. Simultaneously, hotel companies had invested in the development of new hotels and the market was suddenly facing a situation of oversupply and a slowdown of new investments followed. The number of hotels under development in 2009 and 2010 was significantly smaller than just two years before. GDP growth has returned to key economies in the last six years, leading to a rise in disposable income and an increase in demand for hotel rooms (IMF, 2016). This has in turn propelled more investments in new hotels, however the growth in supply is still lower than before the crisis and below the long-term average of 2.1% of annual growth (IHG, 2013)

4.5.1.4 Performance Measures

There are a number of industry performance measures that are commonly used by industry players to benchmark and monitor their operating performance. These include the occupancy rate (OCC), the average daily room rate (ADR) and the revenue per available room (RevPAR). OCC measures the utilization of a hotel's available capacity. It is computed by dividing the number of rooms in a property that have been rented with the total number of rooms in the building. ADR is room revenues divided by the number of rooms sold. It shows the average revenues per occupied room in a given time period. RevPAR measures the period-over-period change in room revenues for comparable properties. It is calculated by multiplying OCC and ADR.

4.5.2 M&A Activity in the Hotel Industry

As we noted earlier, the hotel industry is a rather fragmented industry, where the top 4 players only account for 16% of the total room supply. In theory, this should imply that hotel companies have not been particularly active on the M&A market. Yet in practice, hotel companies have been relatively present in corporate transactions - however not as acquirers, but as targets. As can be seen in exhibit 17, many of the acquiring companies are not strategic buyers, motivated by potential synergy effects, but financial sponsors that intend to pursue a buy low and sell high strategy. Blackstone is by far the biggest player in this respect. The American PE fund has been buying hotels since 1993 for a total deal value of $49 billion. (Touryalai, 2013) Two particular successful investments carried out by Blackstone have been the transactions involving Extended Stay America and Hilton Hotels. Blackstone's $26 Billion Hilton Deal is often described as the most profitable LBO transaction in history and will be discussed more in depth in section 7.1 as it will serve as a best practice example for our investment case.

As for the acquisition of Extended Stay America, it was purchased for $3.1 billion in 2004. At the time of the merger, Extended Stay America operated 475 hotels - a number that Blackstone raised to 589 by incorporating the hotels belonging to Homestead Studio Suites. (Blackstone, 2004) Three years later, in June 2007, Blackstone accepted an offer worth $8 billion for Extended Stay America from Lightstone Group, yet another PE company specializing on hotel properties. But by June 2009, Extended Stay America began feeling the ill effects of the financial crisis and could no longer support the large amortizations and interest payments, forcing the company to file for bankruptcy protection. Creditors took the control from Lightstone Group and ensured continued operations through a debtor-in-possession financing solution.

In July 2010, Extended Stay America was once again acquired by Blackstone. This time through a bankruptcy auction for $3.925 billion - less than half of what Blackstone received for selling the company 3 years earlier. Under Blackstone's management Extended Stay America successfully repositioned itself as a mid-price long-stay hotel targeting business travellers on extended assignments. By renovating properties and introducing popular amenities such as free Wi-Fi and breakfast, it was able to charge a higher average daily rate than competition while at the same time having higher occupancy rates (Yu & Carey, 2013a). In 2013, Extended Stay America raised more than $500 million in an IPO, selling 17% of the shares. Blackstone is today still a major shareholder, albeit in a minority position.

Exhibit 17. Selected Corporate Transactions in the Hotel Industry, 2004 to Present

Global Hotel Industry				
Year	**Target**	**Acquirer**	**Type**	**Deal Value ($m)**
2015	FRHI Hotels & Resorts	Accor	Strategic	2,874
2015	Starwood Hotels & Resorts	Mariott International	Strategic	14,749
2015	Kimpton Hotel & Restaurant Group	InterContinental Hotels Group	Strategic	430
2013	InTown Suites	Starwood Hotels & Resorts	Strategic	735
2012	Accor (US Economy Hotel division)	Blackstone	Financial	1,900
2010	Extended Stay America	Blackstone	Financial	3,925
2008	Regent Seven Seas	Apollo Global Management	Financial	1,000
2007	Hilton Worldwide	Blackstone	Financial	25,081
2007	Red Roof Inns	Citigroup Global Markets	Financial	1,320
2007	Extended Stay America	The Lightstone Group	Financial	8,000
2007	Four Seasons Hotels	FS Acquisition	Financial	3,088
2006	La Quinta Inns & Suites	Blackstone	Financial	3,400
2006	Fairmont Hotels & Resorts	Kingdom and Colony Capital	Financial	3,900
2005	Wyndham International	Blackstone Group	Financial	3,209
2005	AmeriSuites Hotel	Hyatt Hotels	Strategic	600
2004	Prime Hospitality	Blackstone	Financial	790
2004	Extended Stay America	Blackstone	Financial	3,130

Source: Corgel (2008), Own creation

The corporate history of Extended Stay America entails three of the largest corporate transactions in the hotel industry. All three times, the company was sold to a financial sponsor, rather than to a strategic buyer. But what is the reason behind this high number of transactions undertaken by financial sponsors? In section 3.2, we outlined a number of characteristics that make an attractive LBO target.

Based on these characteristics we thereafter performed a screening process, generated a hotel company as the most suitable LBO target for a PE fund. Although being a fast growing company, Rezidor is not unique in the hotel industry – there are many other companies sharing the same characteristics as Rezidor. Hence, it is not a big surprise that the hotel industry has seen a lot of LBO transactions in the past. Thus, based on the identified LBO criterion in Exhibit 6, let us explain why the hotel industry is attractive for PE firms:

First, many hotel companies possess a lot of real estate properties, which serve as good collaterals for receiving debt. Those companies, similar to Rezidor, who operate under an asset-light business model, have on the other hand very predictable cash flows, both in terms of revenues and costs. Second, PE firms finance their LBOs through large amounts of debt, which strategic buyers would be unwilling or even unable to do. The low interest rates of the last years have made it more advantageous to choose debt over equity. (Corgel, 2008) Third is the aspect of market timing. Hotel properties, especially in the US, have fluctuated in value since the event of 9/11 in 2001, making hotel chains attractive to purchase at low prices and selling them off at higher values. That was the case in Blackstone's acquisitions of Extended Stay—both times. (Touryalai, 2013) In periods of low demand such as in 2009, there are few hotel companies with enough financial muscles to compete in bid wars with PE firms. Last, private equities are also attracted to the possibilities of improving the operations or strategy of the hotel companies. As with Extended Stay America, Blackstone brought in new management, repositioned and expanded the company.

However, as displayed in exhibit 17, the last years have been marked by transactions involving strategic buyers, rather than financial sponsors. A primary reason behind conducting this type of acquisition is to expand the network of hotels, increasing the visibility of brands and improving access to loyal customers (Advito, 2016). A major deal took place when Starwood acquired by Marriott International in November last year. The combined entity will create the world's largest hotel company. Most recently, the French hotel operator Accor announced its acquisition of FRHI Holdings, the owner of well-reputed brands such as Swissotels and Fairmont.

4.5.3 Peer Group Definition and Description

For the purpose of valuing Rezidor, a relevant peer group has to be established. As earlier mentioned, Rezidor's portfolio consists of brands that are operating in 4 market segments, namely upper midscale, upscale, upper scale and luxury, of which the upper scale segments represents 66% of the company's hotel portfolio. (Rezidor, 2015a) Furthermore, Rezidor pursues an asset-light business model, meaning that Rezidor does not own the properties of the hotel. As for Rezidor's geographical exposure, we have earlier described Rezidor as being a European hotel chain, with a high focus on the Middle East and Africa.

By taking all these aspects into account, we can define Rezidor's peer group as an "asset-light hotel operator, with a diversified portfolio, but with a primary focus on the upper scale segment and with operations in Europe, Africa and Middle East." The companies that satisfy these conditions, thus being the closest competitors to Rezidor are Intercontinental Hotels, Starwood Hotels, Hilton and Marriott. A brief description of each individual peer will follow below.

4.5.3.1 Intercontinental Hotel Group

As measured in number of rooms, Intercontinental Hotel Group (IHG) is the world's largest hotel company, operating over 710,000 rooms and 4,800 hotels across nearly 100 countries. Although IHG is an English hotel operator, the lion's share of its hotels (76%) are located in the United States. Europe and AMEA account for 13% and 11%, respectively. IHG's business model is dominated by hotels operated under franchise agreements. As measured by hotel rooms, 71.3% of IHG's total number of hotel rooms are under franchise agreement. As for management contracts, its share is 28.4% of the total number of rooms. Only 0.3% of IHG's hotel rooms are owned or leased. IHG has a brand portfolio containing nine hotel brands, of which Intercontinental Hotels and Resorts, Hotel Indigo, and Crowne Plaza form the majority of the total hotel count. IHG's main focus has traditionally been on the upper midscale segment; however, with the recent acquisition of Kimpton Hotels & Restaurants, IHG has started to compete in the upper upscale segment as well. IHG manages IHG Rewards Club, the world's first and largest hotel loyalty programme with over 82 million members worldwide.

4.5.3.2 Hilton Worldwide

US based Hilton Worldwide (HLT) has expanded heavily in the last years and is today the world's second largest operator of hotels, only 2,000 rooms behind IHG. HLT has a global presence, its 708,268 rooms and 4,278 hotels span over 94 countries. The US is HLT's largest market, representing 81% of the group's total number of hotels, while Europe and AMEA account for 10% and 9%, respectively. HLT's business model looks very similar to IHG's, 70.9% of Hilton's hotel rooms are franchised, whereas managed and leased rooms represent 21.1% and 7.9% respectively. HLT is particularly strong in the upper upscale segment, in which its most famous brand "Hilton Hotels" operates. Other areas of focus for HLT are the upscale and the upper midscale segments. HLT's loyalty program, named Hilton Honors, has over 30 million members. The program has partnerships with many major airlines where members can collect both points and airlines miles simultaneously with their hotel stay.

4.5.3.3 Starwood Hotels and Resorts

The world's seventh largest hotel group, in terms of the number of hotel rooms, is Starwood Hotels and Resorts Worldwide (HOT), operating over 346.500 rooms and 1.206 hotels worldwide. HOT's geographic presence is more evenly distributed than IHG and HLT. The Americas remains the largest market (55%), but the company also has a strong presence in the Asia Pacific region, constituting 25% of the hotel portfolio. Regarding HOT's business model, most of its hotel rooms are managed (55.9%), followed by franchised (40.2%), while owned or leased represent 3.9%. HOT's brand portfolio is dominated by brands operating in the upper upscale segment. Famous brands in this segment include Westin, Le Meridien and Sheraton. HOT's loyalty program is called Starwood Preferred Guest and has over 21 million members. 32 airlines are connected to this loyalty program, allowing members to redeem their points for flights.

4.5.3.4 Marriott International

The American hotel operator Marriott International (MAR) is the hotel industry's number three in terms of number of hotels and rooms. MAR recently announced the acquisition of Starwood, a merger that would create world's largest hotel company, with more than 1.1 million rooms. As with IHG and HLT, the Americas dominates MAR's hotel portfolio, representing 85%, while Europe is of secondary importance with 7% of all hotels. Middle East & Africa and Asia Pacific are of equal importance for Marriott, each having 4 % of the portfolio. Concerning its business model, the majority of MAR's rooms is labelled as franchised (58.2%), while hotel rooms under management contract represents 40.8%. Owned or leased hotel rooms account for only 1.0%. MAR is most known for its original brand Marriott Hotels but also for its luxury brand Ritz-Carlton, which was acquired in 1998. The company also boasts one of the industry's leading loyalty programs, namely the Marriott Rewards, which has a member base of 49 million. Marriott Rewards can be redeemed for flights through more than 30 airline rewards programs and was in 2015 awarded the Best Hotel Rewards Program by U.S. News and World Report.

4.5.4 Peer Group Share Price Performance

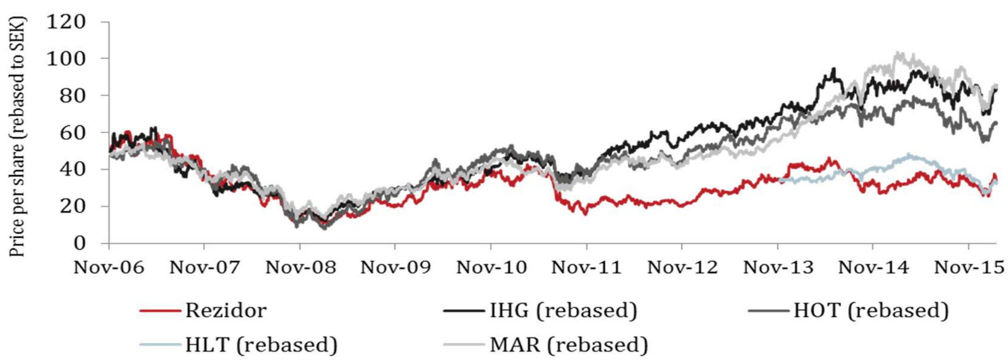
Rezidor's share price development was already addressed and compared with the market portfolio in section 4.5.2. We conclude that over the course of its trading history, Rezidor's stock has yielded a negative return of more than 30%. This raises the question: Are Rezidor's competitors experiencing the same share price development?

As illustrated in exhibit 18, Rezidor's share price went hand-in-hand with its peers until March 2009, which was about the same time when the global stock markets had fallen to the lowest level in the financial crisis. Similar to its competitors, Rezidor's share price recovered in the following two years, until early August 2011, when the global stock markets were tumbling due to the high level of uncertainty about the sustainability of public finances in many European countries. As we noted earlier in section 4.5.1.2, revenues in the hotel industry are to a very high extent driven by business and leisure travel, both of which are significantly affected by the health of the economy. In a poor economy, demand deteriorates, resulting in dropping occupancy levels and average daily rates. Rezidor, having the highest exposure to the European market, compared to its peers, was obviously particularly affected. While its peers experienced high RevPAR numbers thanks to a recovering North American economy in 2012, Rezidor had to deal with a stagnating or even declining demand on its dominating markets, the Nordics & Western Europe. Simultaneously, the Arab spring erupted in several of Rezidor's markets - events that struck Rezidor harder than its peers, due to a higher exposure to North Africa and the Middle East. A deeper description of Rezidor's market developments will be provided in section 5.1.

Between January 2013 and June 2014, Rezidor's share price grew by 81%, a positive development which the peers experienced as well. The growth was driven by recovering world economy – and RevPAR rose quickly in all of Rezidor's regions, except from Eastern Europe. Rezidor's shareholders could also see a significant improvement in the company's profitability, the Q4 quarterly report in 2013 stated an EBITDA margin of 8.8% (Rezidor, 2013c). The company had in the year before promised an EBITDA margin of between 10 – 12% by 2015, which now seemed to be within reach. The stock continued to grow in value until Rezidor announced a stock issue, the first in its corporate history. Rezidor claimed to use the proceeds to terminate unprofitable lease contracts and to accelerate its expansion in emerging markets. The market reacted negatively on this announcement and several months of a tumbling share price followed. Contributing factors to the declining share price were according the Q4 quarterly report in 2014 the political unrest in Ukraine and the falling oil prices, which both had a significant impact on demand in 2 important markets of Rezidor, namely Eastern Europe and Middle East (Rezidor, 2014c). As a result, Rezidor reported lower profitability than the year before, achieving an EBITDA-margin of 7.6% for 2014. (Rezidor, 2015a)

2015 was a strong year for the global hotel industry. Except from Africa, growth in the number of tourist arrivals was conveyed on all continents, while leading economies, in the western world fuelled demand with economic growth. Rezidor improved RevPAR on all markets, which lead to EBITDA margin of 10.1%, meaning that the company reached the lower target range objective set in December 2011. (Svenska Dagbladet, 2016) The market responded positive on the fulfilled target and the share price grew by 19.9% during the three days following the announcement. (Rezidor, 2015a)

Exhibit 18. Indexed Peer Group Share Price Performance (Rebased to Rezidor's Share Price)



Source: Yahoo Finance, Own creation

4.6 Investment Rationale and Rezidor as LBO Target

After having presented our target company, as well as describing its operations and its recent financial performance we would like to summarize section 4 by pinpointing the investment rationale behind Rezidor as an LBO target. We started the target selection process by defining our scope, the target universe. Following a literature review of LBO transactions, we constructed a set of criteria, which we used for screening the target universe. As a result of this method, we identified the most attractive LBO target company, namely Rezidor Hotel Group. The subsequent sections provided useful information about Rezidor and its industry. Rezidor is an international operator of hotels, in the possession of strong brands and having favorable market positions in several markets. Moreover, the company pursues an asset light strategy, with no ownership in properties, which means low operating leverage and by extension low business risk. It has a good track record of increasing revenues with improved EBITDA-margins and low levels of debt. On top of these desirable characteristics, Rezidor has an attractive price, which would increase the likelihood of making a good return. Regarding Rezidor's current ownership structure, it has a majority owner in the form of Carlson Hotel Group, who also is the legal owner of Rezidor's brands. Carlson has recently announced that it is considering the possibilities for a potential sale of its ownership, which makes the case more relevant and realistic. As for Rezidor's industry, the hotel industry, its beta indicated a relatively weak relationship with the overall state of the economy according with Damodaran's (2016) industry beta estimates. Yet, we soon realized that the hotel industry is indeed highly affected by the state of the overall economy. We nevertheless decided to continue with Rezidor, since we would have a very limited range of LBO candidates if we would strictly follow the criteria of a non-cyclical business. In addition, as we showed in 4.5.2, the hotel companies are typical subjects for LBO transactions, which further motivates the choice of Rezidor acting as our target company.

5 Section - Strategic Analysis

In order to assess Rezidor's future cash flows as well as possible, the following section will be devoted to analyze both the internal and external value drivers that will determine Rezidor's future. For the assessment of the prospects of Rezidor's external environment, we will use the Porter's Five Forces framework. We will thereafter plunge into the more company-specific value drivers, examining Rezidor's strategy and activities in the context of the PEST framework. Last in the strategic analysis, we will assess whether Rezidor disposes of the right leadership and management to be successful in the long term.

5.1 Market Analysis

Ever since Rezidor and Carlson Hotels signed the first master franchise agreement in 1994, Rezidor has been in the possession of Carlson's hotel brands in the EMEA region. On one hand the contract implies that Rezidor is constrained to these regions and would have to refrain from an expansion to the Americas or Asia Pacific – markets that legally belong to Carlson. On the other hand, the contract has enabled Rezidor to focus on its core markets, the Nordics and Western Europe, as well as a couple of niched and unexploited markets in Eastern Europe, the Middle East and Africa. The following sections will portray the macroeconomic development in each of Rezidor's markets, as well as the development of tourism, which is measured by the number of foreign tourists arriving to a country each year. Moreover, they will cover the precise demand and supply for hotel accommodation. Hotel demand is measured in the number of hotel guest nights spent per year, while supply is measured in the number of hotel rooms in each region multiplied by the number of days per year. Each section will also show the three most important performance metrics of each region, namely OCC, ADR and RevPAR, as described in sub section 4.1.6.4. Last, we will compare Rezidor's performance with the industry average of the region.

5.1.1 The Nordics

Given their small, open and export-led economies, the Nordic countries were among the first countries to be hit by the financial crisis, but were also among the first to recover. While all Nordic countries experienced positive GDP growth in 2010 and 2011, the countries have been following diverging growth patterns since, as can be seen in exhibit 19. Analysts expect growth rates to continue to be uneven - the overall expectation is an annual growth rate of 2.1% in the next 5 years.

The solid macroeconomic foundation in combination with the greater influx of international tourist arrivals has in the recent years created a growing demand for hotel services in the Nordic region. During the last three years, the number of tourist arrivals has increased by an annual average of 3.8% (CAGR) compared 3.4%, which is the average annual growth rate for Europe as whole. (UNWTO, 2015) Demand, as measured in the number of hotel nights spent, has increased at the same pace. Supply of new hotels has on the other hand not been able to grow at a similar speed. As a consequence, the Nordic hotel market has been flourishing, showing solid growth rates on both occupancy rates and average daily rates, leading to an increasing RevPAR. (Hodari & Larsen, 2015)

Exhibit 19. Market Statistics of the Nordic Market

The Nordics						
Measures of Demand	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
GDP Growth	1.9%	0.4%	0.4%	1.6%	1.6%	1.2%
YoY Change in Tourist Arrivals	1.9%	1.7%	3.5%	7.0%	4.8%	3.8%
YoY Change in Guest Nights	4.8%	2.5%	4.7%	4.0%	2.8%	3.8%
Measure of Supply						
YoY Change in Guest Rooms	1.8%	2.3%	1.5%	1.2%	1.4%	1.6%
Measures of Performance						
ADR (in EUR)	92	99	96	105	119	5.2%
OCC	70%	70%	73%	75%	76%	1.5%
RevPAR (in EUR)	65	70	70	78	90	6.8%
YoY Chg in RevPAR	4.2%	8.4%	-0.6%	12.1%	15.0%	

Source: STR (2016), UNWTO (2016), IMF (2016), Own creation

5.1.2 Rest of Western Europe

Countries that are located outside the Nordic region, but still belong to Western Europe are countries that Rezidor has chosen to categorize "Rest of Western Europe." Just as the Nordic countries, the economies of Western Europe saw a slowdown in economic activity during the financial crisis. While the Scandinavian countries recovered fairly quickly, growth in Western

Europe was put on hold, especially in the southern European countries, which were suffering from the subsequent European Debt Crisis. As can be seen in exhibit 20, it was not until 2014 that the economies of Western Europe could return to adequate growth rates. The development of tourism in Western Europe shows a similar pattern as GDP for the same period. Western European tourist destinations have increased the number of tourists by 4.1% annually (CAGR) and the number of hotel nights spent have grown at an annual rate of 2.4% (CAGR). Supply has on the other hand has almost stagnated since the financial crisis, which has contributed to a decent annual increase in RevPAR by 3.1% (CAGR).

Exhibit 20. Market Statistics of the Western European Market

Rest of Western Europe						
Measures of Demand	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
GDP Growth	1.7%	-0.5%	0.2%	1.4%	1.7%	0.9%
YoY Change in Tourist Arrivals	6.3%	2.6%	4.0%	4.6%	3.2%	4.1%
YoY Change in Guest Nights	3.7%	0.0%	2.0%	3.3%	2.9%	2.4%
Measure of Supply						
YoY Change in Guest Rooms	0.8%	0.5%	0.5%	0.6%	0.4%	0.6%
Measures of Performance						
ADR (in EUR)	106	108	108	109	116	1.8%
OCC	64%	64%	65%	66%	68%	1.2%
RevPAR (in EUR)	68.2	68.8	69.8	72.6	79.2	3.1%
YoY Chg in RevPAR	6.0%	0.9%	1.5%	4.0%	9.2%	

Source: STR (2016), UNWTO (2016), IMF (2016), Own creation

5.1.3 Eastern Europe

The Eastern European economies that prior to the economic crisis were in a state of severe overheating, were particularly hit by the financial crisis (Åslund, 2011). The sudden decline in demand and difficulties in receiving foreign capital resulted in a steep drop in GDP for many of the Eastern European countries. Yet for most of Eastern Europe, the recession only lasted for one year and the region quickly picked up the growth rates it had before 2009. Driven by the influx of tourists from Western Europe, Eastern Europe has in the last 10 years seen a tremendous development in terms of tourism growth. The largest contributing factors for this development were the deregulation of the European airline industry and the success of the low-fare airlines thereafter. As can be seen in exhibit 21, growth for both tourism and GDP was lower in 2014 than in the years before. This is to a large extent a result of the recent events in Ukraine, which has severely affected Western tourist demand for Russian and Ukrainian tourist destinations. Tourist flows are also decreasing from the opposite direction, namely from Russia, due to a weaker Russian currency. (Kolyandr, 2014)

Development in demand, as measured in the number of guest nights, was therefore declining by 2.0% in 2014, but rebounded by 7.4% last year. Supply has for the same period been rather low, averaging a 1.7% annual growth rate. As can be seen in exhibit 21, RevPAR has in this region been relatively volatile in the last years, which can be explained by the unstable demand.

Exhibit 21. Market Statistics of the Eastern European Market

Eastern Europe						
Measures of Demand	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
GDP Growth	4.9%	2.4%	2.3%	1.8%	0.0%	2.3%
YoY Change in Tourist Arrivals	5.6%	7.5%	14.0%	0.0%	4.6%	6.2%
YoY Change in Guest Nights	7.3%	3.9%	3.7%	-2.0%	7.4%	4.0%
Measure of Supply						
YoY Change in Guest Rooms	1.3%	1.8%	1.5%	2.4%	1.7%	1.7%
Measures of Performance						
ADR (in EUR)	83.9	88.2	84.0	75.4	71.8	-3.1%
OCC	58%	59%	60%	58%	61%	1.1%
RevPAR (in EUR)	48.6	52.1	50.7	43.6	43.8	-2.0%
YoY Chg in RevPAR	7.8%	7.3%	-2.7%	-14.1%	0.6%	

Source: STR (2016), UNWTO (2016), IMF (2016), Own creation

5.1.4 Middle East and Africa

Thanks to the huge oil resources of the region and the relatively high prevailing oil prices, many economies in Africa and the Middle East were able to escape the financial crisis relatively unaffected. High commodity prices have traditionally been a requirement for development in Africa, but this situation has changed in the past years. Today, exports from commodities only represent a third of the economy, according to McKinsey. The remainder stems from other sectors, including wholesale and retail, transportation, telecommunications, and manufacturing. (McKinsey, 2010) Countries of the Middle East region have not undertaken similar efforts in diversifying their economies and are currently experiencing low growth, as oil prices are low. Political turmoil in large parts of the Middle East is another contributing factor to the slowdown in economic activity.

The prevailing political instability in North Africa and the Middle East has also scared away many tourists, leading to stagnation in terms of international tourism. However, the Middle East and Africa continue to report the world's highest average daily rates. This is explained by strong growth in larger and more international African capitals, attracting a rising number of business travelers. Supply has in the last five years been on the rise in the entire MEA region, but particularly in the Middle East, averaging a 6.1% annual growth rate, compared to the 1.0%

annual growth rate of African hotel supply. Gulf countries such as Saudi Arabia and Qatar and the United Arab Emirates have in the last years been expanding heavily. (Wooller, 2015)

Exhibit 22. Market Statistics of the Market in Africa and the Middle East

Middle East & Africa						
Measures of Demand	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
GDP growth (%)	4.7%	4.8%	3.1%	3.3%	2.8%	3.7%
YoY Change in Tourist Arrivals	0.1%	0.3%	-1.7%	3.1%	0.9%	0.5%
YoY Change in Guest Nights	-7.2%	9.7%	3.0%	6.4%	1.6%	2.6%
Measure of Supply						
YoY Change in Guest Rooms	3.0%	2.8%	2.7%	2.6%	2.3%	2.7%
Measures of Performance						
ADR (in EUR)	105.8	109.3	107.7	106.4	121.0	2.7%
OCC	61%	55%	59%	59%	61%	-0.1%
RevPAR (in EUR)	60.0	65.8	65.3	66.8	75.2	4.6%
YoY Chg in RevPAR	-10.8%	9.7%	-0.7%	2.2%	12.6%	

Source: STR (2016), UNWTO (2016), IMF (2016), Own creation

5.1.5 Rezidor's Performance in each Geographical Segment

As we earlier pointed out in Section 4.4.4 and illustrated in exhibit 13, Rezidor has in recent years been investing heavily in the Middle East and Africa, increasing its share of the total hotel portfolio from 13% in 2011 to 18% in 2015. These investments have in turn proven to be a good decision. Rezidor has managed to increase its RevPAR annually by an average growth rate of 7.2%, compared with the market average of 2.3%. This is an astonishing achievement, considering that the market supply (2.7%) has been growing faster than the demand (2.6%) during this period.

Another region, in which Rezidor has been expanding significantly, is Eastern Europe, which is also reflected in the region's share of the total portfolio. In 2011, Eastern Europe represented 19% of the hotel portfolio, while in 2015, its share had grown to 27%. However, during the same period, Rezidor's RevPAR declined by 2.0% annually. Rezidor's hotels in Western Europe (excluding the Nordic countries) show the opposite development. It accounted for half of Rezidor's total hotel portfolio in 2011 and has in the last 5 years dropped to 38%. Simultaneously, Rezidor has reported higher annual growth rates in RevPAR than the industry average on this market. In retrospect, one can argue that Rezidor has pursued a too aggressive expansion in Eastern Europe, while missing lucrative investment opportunities in Western Europe. As for Rezidor's home market, the Nordics, Rezidor had about the same share of its total hotel portfolio five years ago (18%) compared to today (17%). Rezidor's RevPAR has been growing, yet at a much slower pace compared to the market. The Nordic market is characterized by mid-market brands, permitting Rezidor to be the market leader in the upper upscale segment with Radisson. This segment has however been rather unsuccessful in recent years when companies are cutting travel expenses in Norway and Finland, whose economies have stagnated.

Exhibit 23. Rezidor's Regional RevPAR Development 2011 – 2015

Rezidor RevPAR Development by Region (in EUR)							
Region	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**	**Market CAGR**
Nordics	86.0	90.9	94.4	88.5	88.1	0.5%	6.8%
Rest of Western Europe	67.3	70.9	73.3	78.8	89.7	5.9%	3.1%
Eastern Europe	49.0	52.9	52.3	45.5	44.3	-2.0%	-2.0%
Africa & Middle East	51.2	61.2	66.2	69.1	72.4	7.2%	4.6%

Source: Rezidor (2011a-2015a), Own creation

5.2 Competitive Analysis

The previous section showed the Rezidor's RevPAR development compared to the overall competition in its four markets. We could conclude that Rezidor had in the recent years made successful investments in the Africa & Middle East region, while the expansion in Eastern Europe has coincided with a declining RevPAR. While this analysis provides a good picture of Rezidor performance relative to the overall competition, we know little how Rezidor is performing compared to its peer group, operating in the same market segments as Rezidor. These peers were earlier defined and described in Section 4.6.3. Unfortunately, Rezidor's peers do not have the same division of markets as Rezidor. They are instead treating the European market as a whole, hence not reporting specific details such as RevPAR in the Nordic region. To make Rezidor comparable with its peers, we have therefore chosen to bundle Rezidor's European markets into one single region, by giving each individual market weights that correspond to their share of Rezidor's European hotel portfolio. In other words, we have calculated Rezidor's European RevPAR, by taking the relative share of each individual market into account.

5.2.1 Europe

As illustrated in exhibit 24, Rezidor has in the last years experienced a lower annual growth rate than both its peer group and the overall competition on the European scene. The last two years have been particularly troublesome for Rezidor, experiencing declining and modest RevPAR development in 2014 and 2015, while the peers have reported a steady increase. One explanation to the poor performance is Rezidor having the highest exposure to Eastern Europe, which in the past five years has reported low levels of RevPAR (Rezidor, 2015b). Another reason is that Rezidor, compared to its peers, has a lower share of its European hotel portfolio in Western Europe, which has seen a steady growth in the past five years. We could also see from previous section, that Rezidor has reported a slow growth rate in its home region, Scandinavia, while the region as a whole has grown significantly, as measured in RevPAR.

Exhibit 24. Rezidor RevPAR Development in Europe Compared to its Peer Group

RevPAR Development Europe (%)						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
Rezidor	na	6.0%	2.0%	-2.7%	4.6%	2.0%
IHG	na	na	0.2%	7.5%	15.2%	5.5%
Hilton	na	na	na	5.3%	10.8%	5.3%
Starwood	15.0%	-3.6%	2.0%	4.1%	6.5%	1.8%
Marriott	10.7%	4.2%	-1.6%	11.6%	10.1%	4.7%
Peer Group Average	-1.8%	1.5%	1.0%	6.9%	8.1%	3.4%
Market Average	5.8%	2.8%	0.7%	4.1%	9.8%	3.4%

Source: Bloomberg (2016), Own creation

5.2.2 Middle East and Africa

As we concluded in Section 5.1.5, Rezidor has in the last years been successful in the Middle East and African region, growing significantly faster than the average competitor. As we can see in exhibit 25, Rezidor's RevPAR growth did also outpace the performance of its peer group. Especially Sub-Saharan Africa has been Rezidor's area of focus since 2000, when it opened its first hotel in Africa (Carlson, 2014). Being a first-mover in the region, Rezidor could in the first years enjoy the benefits of being shielded by high barriers of entry (Rezidor, 2010b). In the last five years, Rezidor has been the most aggressive player in this region, a good choice, considering the fast economic growth of 5% per annum. With regards to North Africa, Rezidor was fortunate to have a rather low exposure to countries affected by the Arab spring and the preceding political turmoil.

Exhibit 25. Rezidor RevPAR Development in Europe Compared to its Peer Group

RevPAR Development Africa & Middle East (%)						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR**
Rezidor	na	19.6%	8.2%	4.4%	4.8%	7.2%
IHG	na	na	0.8%	-3.2%	16.5%	3.2%
Hilton	na	na	na	5.6%	15.6%	6.9%
Starwood	-2.4%	5.3%	2.0%	-1.9%	24.2%	5.6%
Marriott	-13.1%	7.9%	-2.2%	38.4%	16.9%	11.3%
Peer Group Average	-5.2%	8.2%	-1.0%	7.4%	18.5%	6.4%
Market Average	-10.8%	9.7%	-0.7%	2.2%	12.6%	4.6%

Source: Bloomberg (2016), Own creation

5.3 Porter's Five Forces

Porter's five forces is a tool that is used to assess the attractiveness of an entire industry. Yet in this case, we will limit this analysis to Rezidor's main markets and disregard the Americas and the Asia Pacific region. We will also focus on the upper segments of the hotel industry, as Rezidor does not operate in budget segments. The following sections are devoted to describe the five forces of the hotel industry more in detail. At the end of each section, we will conclude by assessing what impact each force has on the industry's attractiveness.

5.3.1 Threat of New Entrants

The level of threat from new entrants is foremost determined by certain characteristics of the industry that deter potential entrants from entering. As for the hotel industry, the high amount of capital needed is one such hurdle for potential entrants. To be competitive, companies are forced to invest heavily in advertising, differentiation efforts, employees, and real estate. Furthermore, new hotels are often built in large sizes – optimally designed to accommodate more than 500 people in order to achieve considerable scale economies. (Cheng, 2013, p. 52)
Another barrier of entry is brand loyalty of customers. Many high-frequency travelers maintain a very strong bond with a particular brand loyalty program. As a matter of fact, two out of three high-frequency travelers stay with the same hotel brand, regardless in which city (Jennings et al., 2014). This means that these customers have higher switching costs when changing the hotel brand they are used to, which in turn makes them more difficult to "win over" in the short term.

Perhaps the most important entry barrier is the availability of suitable locations. According to a recent study by JD Power and Associates (Martin, 2013), location is among global travellers the most important reason for choosing a hotel. Since the best locations are already occupied in most cities, location becomes a difficult barrier to circumvent for new entrants. There are however many possibilities for a hotel operator to stand out from the competition, by product differentiation, which reduces the entry barriers to some extent.

Conclusion: "It is clear that the lodging industry has a lot of entry barriers, which is rather unattractive to potential new entrants, but in turn increasing the attractiveness for existing members, as well as generating scale efficiencies for the bigger players."

5.3.2 Threat of Substituting Products

Opposite to the threat of new entrants, the threat of substituting products in the hotel industry is very real. When looking for a place to stay, consumers have many options besides hotels: Bed and breakfasts, private accommodation, corporate travel housing and camping. A new serious threat of substitute to the hotel industry has emerged from the online room-sharing site Airbnb. A study conducted by Zervas & Prosperio (2016) shows that the presence of Airbnb has led to a decline in hotel revenues by about 8% to 10% over the last years in areas where Airbnb is most popular. The authors found that this effect is disproportionately larger on independent hotels and lower on recognised hotel chains providing more differentiated services. This suggests that Airbnb does not constitute a major immediate threat of substitute products in the "upper" strategic groups, for example, those particularly catering for business traveller, who put much higher value on service. Unlike budget-conscious holidaymakers, who are willing to book a room in a stranger's home on Airbnb to save some money, most business travellers are using their corporate expense accounts. Airbnb could however, become a real threat, in the case of an economic recession, which would force companies to cut back on their expenses. Another possible scenario that would attract the upper segment is if Airbnb decides to offer a supplementary and more differentiated service to its current product offering.

Conclusion: "Based on the above mentioned substitutes it is reasonable to say that substituting products constitute a threat to the industry, making the industry as a whole less attractive."

5.3.3 Bargaining Power of Suppliers

Suppliers of the hotel industry are numerous and can easily be switched. These include: Employees, real estate brokers, interior design and furnishings companies, architects, management and training service providers, marketing companies and industry consultants. (Lehr, 2015) The main groups of suppliers that are particularly important to hotels are employees and real estate brokers. Hotel employees are able to exercise some bargaining power, as their work accounts for a large part of the perceived quality of the hotel. Good relationships with a real estate brokers is particularly useful when expanding the chain to a new attractive location, because it can result in a favorable price or contract.

Conclusion: "We assess the threat of supplier power on the hospitality industry to be relatively low, as hotels often can choose between many suppliers. As a result, the attractiveness of the hotel industry increases."

5.3.4 Bargaining Power of Consumers

The bargaining power of consumers is higher than that of the suppliers because consumers have the possibility to gather information at a low costs and compare different hotel offerings with one another, choosing the best alternative. Due to the high transparency, it is therefore difficult for hotels to charge prices above the market price for the offered service. The consumer bargaining power also becomes visible, when individual companies purchase hotel nights at large quantities, which is the case for instance with tour operators and convention organizers. The higher the volumes that they are purchasing, the more negotiating power will they have. As previously discussed, a common practice employed by hotel chains is to reward their most devoted customers through loyalty programs. This is an efficient way to reduce the customer's bargaining power, because it reduces the member's incentives to look for other alternatives.

Conclusion: "Given that consumer power is lower in the upper segments of the industry, due to higher customer loyalty, we assess this force to be neither weak nor strong. This force does therefore not have any impact on the industry attractiveness."

5.3.5 Rivalry among Competitors

The rivalry among competitors in the hotel industry is strong, which might be explained because of the relatively high proportions of fixed costs compared to variable costs. As explained in section 3.4, low levels of variable costs allow firms to attain economies of scale by increasing their volumes. In order to attract higher volumes, hotels therefore reduce prices, leading to price wars between competitors during periods of low demand. Price wars can be perceived as signs of intense competition in an industry. (Porter, 2008, p. 85) Webpages such as hotels.com further intensifies these price wars, because they allow consumers to compare the discounted rates of various hotels. Hotels announce their available rooms on this webpage to attract last minute hotel guests, in an effort to increase the occupancy rate. Since consumers generally select the lowest price, given the chosen level of quality, hotels operating in the same segment have no choice but to compete with each other on price.

Another way to assess the intensity of competition is to compare the relative size of firms with the size of their industry as a whole. (ibid, 2008, p.85) Firm size is most often measured in sales and the relative size is therefore the ratio between a company's sales and the industry's total sales. However, using sales to measure the relative size of a hotel company is not common practice in the hotel industry. This is because hotel companies apply different business models, which, as explained in section 4.3.1 generates varying levels of revenues. A company that for instance leases most of its hotels has substantially higher levels of sales because it is responsible for all revenues and costs. In contrast, a company, who operates most of its hotels with management contracts receives much less revenues, but hardly bares any of the costs. A more representative estimate of market shares in the hotel industry is therefore the number of hotels and hotel rooms as a fraction of the total number of hotels rooms.

Exhibit 26. Global Market Shares by Room Supply

Room Count (000's)	2007		2011		2015		2011 - 2015
Company	**# of rooms**	**% of total**	**# of rooms**	**% of total**	**# of rooms**	**% of total**	**CAGR**
IHG	556	3.9%	647	4.4%	710	4.5%	1.9%
Hilton	498	3.5%	606	4.1%	708	4.5%	3.2%
Mariott	502	3.5%	602	4.1%	693	4.4%	2.8%
Wyndham	543	3.8%	606	4.1%	661	4.2%	1.8%
Choice	429	3.0%	495	3.3%	505	3.2%	0.4%
Accor	487	3.4%	507	3.4%	482	3.0%	-1.0%
Starwood	266	1.9%	309	2.1%	354	2.2%	2.8%
Best Western	315	2.2%	307	2.1%	304	1.9%	-0.2%
Carlson Rezidor	146	1.0%	165	1.1%	296	1.1%	0.9%
Rezidor only	49	0.3%	71	0.5%	79	0.5%	2.1%
Others	10,417	73.3%	10,485	70.8%	10,936	68.8%	0.8%
Industry Total	14,208	100%	14,800	100%	15,900	100%	1.4%
CR4	2,099	14.8%	2,461	16.6%	2,772	17.4%	2.4%

Source: MKG Hospitality (2007-2015), Own creation

Exhibit 26 depicts the development of market shares for Rezidor, Carlson Rezidor and the 8 largest competitors in the global hotel industry over the last 5 years. As can be understood from CR4, the competition in the industry is fierce as the combined market shares of the top 4 players amounted to only 16.4% in 2010 and 17.4% in 2015. As no one holding more than 5% of the hotel rooms, it is not possible for a single company in a position to dominate or influence the industry as a whole. However, as described in section 4.6.2, there is evidence that the industry is moving slowly towards increased consolidation. In November 2015, Marriott announced that its USD 12.2 billion bid to take over Starwood to form the world's biggest hotel company. (Hoffman & Karmin, 2015) One month later, Accor Hotels agreed to buy FRHI, the owner of the luxury brands Fairmont and Swissotel, for about USD 2.9 billion. (Fahmy, 2015)

Conclusion: We conclude that the lodging industry is highly competitive, which incentivizes price wars, low margins and competitors trying to steal profit and market share from each other. There are however signs, that the industry is moving towards increased concentration, which reduces this force a little. Yet the intensity of competition is strong, especially in the upper segments, making the industry unattractive.

5.4 PEST

In the following section, we will analyse Rezidor's macro-environmental factors using the PEST framework.

5.4.1 Political Factors

The major political factors that could affect Rezidor's business are the danger of terrorism and international relations between important economies (Hilton, 2013b). Regarding the threat from terrorism, there have been several incidents in the past year which have scared people away from travelling. Examples of such events include the coordinated terrorist attacks in Paris, November 2015 and in Bruxelles, March 2016. The rise of aggressive new terrorist organizations such as ISIS make people avoid public places with large crowds, such as famous tourist attractions, but also airports and train stations. Logically, any decline in demand for transportation would decrease the demand for hotel accommodation.

Another political risk that Rezidor and the hotel industry is facing is that terrorist's attacks will appear on tourist sites or hotels directly. Also in this regard, there have been cases where terrorists have targeted hotels and other tourist sites. For instance, in June 2015, 39 people, including tourists, were killed on a beach in Tunisia. In March 2016, 16 people were killed when gunmen opened fire at a beach resort in Grand-Bassam, Ivory Coast. (Laing, 2016)

Yet another source of political risk for Rezidor is changes in political relations between large economies. The conflict in Ukraine is one such event that has had an impact on trade flows and tourism between the countries of Europe. In the beginning of 2014, the EU introduced a series of economic sanctions against Russia in protest at Russian involvement in destabilizing Ukraine and violation of Ukraine's territorial integrity. Russia responded by imposing trade restrictions on certain EU agricultural products. Although the overall impact on the EU economy has been rather limited, certain countries are more significantly affected. Finland, the Baltic countries, Armenia, Georgia, and Moldova are countries that are highly dependent on Russia for their state revenues. Lower demand from Russia has had negative consequences on trade flows with Russia and by extension also affected the demand for hotel services. The Russian economic downturn has also had a negative impact on tourist destinations in Western Europe. The weakened rouble has gradually reduced outbound travel from Russia. The climate of economic uncertainty, fear of hostile attitudes towards Russians and deteriorated visa processing, amplified by media coverage, are all contributing factors that discourage Russian tourists from spending their vacation abroad. Also the Russian hotel industry has been hit hard in recent years, influenced by the negative news feed reported by media. Between 2014 and 2015, the number of tourists declined by 35% (Wilder, 2015). For companies like Rezidor, with substantial operations in Eastern Europe and Russia, this development is bad news. Rezidor has 13% of its room stock in the Russian market – its 27 hotels make it the largest foreign hotel operator in the country. Although the company saw a decline of 28.6% in RevPAR on the Russian market in 2014, it has plans to continue its expansion with additional 13 hotels under development (Rezidor, 2015b).

5.4.2 Economic Factors

The major economic factor that will affect Rezidor's business is the slowing of economic growth in Rezidor's main markets. Such economic slowdowns reduce individuals' buying power and their willingness to travel. The biggest effect of this is the tapering off in business travels, which Rezidor is heavily dependent upon. We have earlier given detailed information about the hotel industry's dependency on the overall economy and will therefore proceed to the next factor in the PEST.

5.4.3 Social Factors

Social factors refer to changes in customer demand that will have an effect on the hotel industry. Over the past six decades, international tourism has undergone a tremendous growth, from 25 million arrivals in 1950, to 278 million in 1980 and 1133 million in 2014. (UNWTO, 2015) Growing competition and capacity amongst airlines, lower air fares and more relaxed travel restrictions in many regions are factors that have fueled this surge. And the growing popularity of tourism is expected to continue. The UNWTO estimates that international tourist travels will increase by 3.8 % a year until 2020 reaching 1.3 billion by 2030. (Ibid) One explanation for this projected surge in international tourism is the increase in average incomes in emerging countries. The size of the "global middle class" will grow from 1.8 billion in 2009 to 3.2 billion by 2020. These will people will also more frequently than before travel to neighboring emerging countries, rather than to traditional destinations in Europe. (Pezzini, 2012) The UNWTO has forecasted that tourism in emerging countries will grow by 4.9% a year, which is more than twice as fast as projected for advanced economies (+2.6% a year) until 2020. As a consequence, tourist volumes in emerging countries are expected to exceed those in advanced economies before 2020. (UNWTO, 2015) Rezidor Group is well positioned for this shift. It states that that its "strategy is to focus its expansion in the emerging markets of Eastern Europe, the Middle East and Africa." (Rezidor, 2014a) Today, 63 of Rezidor's 355 hotels worldwide are located in emerging markets. Additionally 61 are under development, which represents 50% of Rezidor's total hotel pipeline.

Another shift in consumer demand is currently taking place through the growing number of so called "Millennial Travelers", defined as people born in the 1980's or later. Rezidor (Rezidor, 2014b) claims that this new generation of hotel guests will represent half of the global hotel demand in 2020 and is of particular interest for Rezidor as they soon will constitute the majority of business travelers, which is the firm's largest customer segment. In contrast to the Generation x, those born between 1965 and 1979, Millennial Travelers value experiences higher than the luxury of items. (ibid, 2014) Further, they prefer hotel environments where they can meet new people, which requires an inviting atmosphere to congregate with tasteful design. Millennials are less inclined to eat in the hotel restaurant, but are often willing to use this space for work, as they are used to open office spaces (IHG, 2013). Millennials are embracing self-service technology in hotels more than past generations and do not appreciate paying extra for Internet access. These distinct preferences are currently challenging hotel operators to adapt to the growing customer segment. As a result, the hotel industry has in the last couple of years experienced an emerging number of new brands, tailored to meet the demand of the Millennial Travelers. As described in Section 4.3.2, Rezidor's move for this purpose has been to launch the new brand Radisson RED.

5.4.4 Technological Factors

Technology is playing an increasingly important role in shaping the hospitality industry. As already mentioned in Porters' Five Forces, online room-sharing sites such as Airbnb are reaping currently significant market shares from the hotel industry. But technology does not only constitute a threat to the industry. There are substantial opportunities to catch as well. Smart phones, for instance, offer the potential to transform the in-hotel guest experience and may generate additional revenue streams. Ordering room service via a hotel app, or choosing your breakfast so it is ready for you at the table are services that are already being offered by Hilton's app. (Solomon, 2014) Moreover, smart controls could allow guests to personalize their rooms in advance via the hotel app, pre-setting room temperatures and lighting preferences, and even selecting the choices for their mini bar. Rezidor does currently not have a mobile app of its own, but is planning to launch one for its new brand Radisson Red. This app will for instance allow guests to skip reception for check-in, order room service and book a taxi for the airport. (Shankman, 2014) Guests staying at other hotels in the Rezidor portfolio have today the possibility to use an app called iConcierge, which offers similar services.

Another technological shift in the hospitality industry is the use of robots. Since August 2014, a Starwood Hotel in Cupertino is deploying robotic butlers to serve guests. The objective is to take over routine errands from the hotel's personnel which frees up resources and allows them to create a more personalized experience for guests. (Solomon, 2014)

5.5 Summary of Strategic Analysis – SWOT Analysis

As with section 4.6 Investment Rationale, we would like to use the final section of the strategic analysis to summarize our findings. A helpful tool is to illustrate this through a SWOT-analysis, which will also serve as a preparation for the forecasts in section 8.

Exhibit 27. SWOT Analysis

Strengths	Weaknesses
• Fragmented markets fit Rezidor well • Secure business model • Attractive market position in Sub-Saharan Africa	• Disappointing RevPAR development in the Nordics • Small size is disadvantageous • No possibilities to expand to the Asia Pacific Region
Opportunities	**Threats**
• Good position to meet the technological shift • Radisson Red • Favorable demand conditions	• Increased political risk • Increased exposure to commodity prices • Brand dilution by mismanaging franchisees • Airbnb and changing customer preferences

Source: Own creation

5.5.1 Strengths

Both Rezidor's regions of operation, Europe and Middle East & Africa, have a higher proportion of non-branded than branded hotels. Studies show that the branded hotels are reaping market shares from unbranded, as there are significant advantages in the form of reduced overhead costs and better possibilities to create a loyal customer base. Rezidor is in a good position to be part of this development. Rezidor pursues an asset light expansion strategy, meaning that less capital is required, since Rezidor is not interested in owning its properties. This in turn implies that Rezidor is able to expand quicker and at a larger scale than many of its European competitors, which are rather asset heavy. Moreover, Rezidor possesses a diversified brand portfolio, containing two well-recognized brands in the form of Radisson and Park Inn and which customers can rely on to receive the same standard and service in any hotel across the world.

As opposed to many of Rezidor's European competitors such as Accor, Groupe du Louvre, NH Hoteles, Rezidor operates an asset-light business model. In addition, Rezidor has in the past years phased out numerous leased hotels in favor of adding franchised hotels to their portfolio. Such a hotel portfolio is considerably safer and less exposed to sudden changes in demand and property prices, compared to most of the competing hotel companies in Europe and MEA. However, during periods with favorable market conditions, Rezidor's hotel portfolio implies lower earnings than the competition since management and franchise contracts only entitle Rezidor to shares of the revenue and not all of the revenues, as with lease contracts.

In exhibit 26, we showed that Rezidor belongs to the fastest growing hotel companies in the world. This growth has in the past years been directed primarily towards unexploited markets in Eastern Europe and MEA, making Rezidor one of the top players in these regions. Many countries in Sub-Saharan Africa have stepped up their efforts to diversify their economies and are now growing despite low commodity prices. Their economic growth in the last years has also been mirrored in the increasing number of international business travelers, who are willing to pay more and more for accommodation, since supply of new hotels is not keeping up at the same speed. One explanation is that funding is time-extensive. Yet the partnership with Afrinord has put Rezidor "in a strategic advantage". For several consecutive years, Rezidor has had the largest pipeline of all hotel companies in the region, an asset that will generate good cash flows in the years to come, considering that all are under management contracts.

5.5.2 Weaknesses

As we saw in exhibit 23, Rezidor has in the last 5 years reported disappointing RevPAR growth rates for two of its markets, namely the Nordics and Eastern Europe. While the development in Eastern Europe can be explained by political unrest, resulting in a negative demand chock for the entire industry, Rezidor's deceiving RevPAR growth rates in the Nordics are harder to explain. The Nordic hotel industry has over the past 5 years experienced a surge in demand, thanks to their expanding economies and growing tourism sector. The low performance in the Nordic region, is definitely a weak spot for Rezidor.

Another weak spot for Rezidor is its small size. As showed in exhibit 26, Rezidor's global market share in 2015 was 0.5% and 1.1% as measured together with its owner Carlson Hotel Group. While Rezidor is a recognized player in many markets in the EMEA region, where the American giants have little presence, they would still be vulnerable if Hilton, Starwood or Marriott would start a price war in order to eliminate Rezidor on favorable locations, especially considering the fact that competition authorities may not be as strong as in some of Rezidor's markets as in Western societies. Rezidor's size is also a disadvantage, when it comes to attracting and retaining customers through its loyalty program. Rezidor's network of hotels is simply not as large as its main competitors.

One last weakness of Rezidor is its dependence of its owner and the owner of the brand portfolio, Carlson Hotel Group. The relationship with Carlson hinders Rezidor to expand to new markets in the Asia Pacific region, which is cumbersome, considering that this is where most of the global growth is taking place. It is also troublesome for Rezidor, because it limits Rezidor's possibilities to diversify its hotel portfolio.

5.5.3 Opportunities

Section 4.5.1.2 dealt with the global demand for hotel services. Judging by its drivers, the outlook is quite promising for Rezidor's markets and for the global hotel industry as a whole. Tourism is expected to grow by 3.2% and 4.2% in Europe, by 2.4% and 3.3% in Africa for 2016 and 2017. The highest growth rates in terms of tourism will be achieved by the Middle East, expecting 4.3% in 2016 and 5.2% in 2017. (Statista, 2015) IMF predicts an annual increase of 4.3% in GDP in MEA between 2016 and 2020. Estimates for GDP growth in Rezidor's European markets are around 2% per year for the same period. Oil prices are expected to remain low in future which together with continued price competition in the airline industry makes transportation more affordable, especially on long-distance routes. A surge for hotel demand in the coming years implies big opportunities for Rezidor increase its earnings.

As we saw in section 5.4.4, the international hotel industry is currently facing a technological shift, in which significant cost reductions can be realized. Examples of this technological trend are apps that serve as hotel keys or robots replacing hotel personnel in running routine errands. Rezidor is currently developing such an application that will be applied in Radisson Red hotels.

Rezidor's new concept Radisson Red is otherwise an opportunity itself. As we know from section 5.4.3, customers born after 1980 are projected to represent half of all travelers by 2020. These consumers are different in their travel habits and expect different kinds of services than previous generations. Designed to appeal this new generation travelers, Radisson Red has a lower emphasis on service, instead focusing more on modern design, connectivity and technology.

5.5.4 Threats

Due to its rapid expansion in Eastern Europe and the MEA region, Rezidor is becoming more and more vulnerable to factors that are beyond the company's control. The situation in Ukraine is one such example that is troublesome to Rezidor, affecting hotel demand in the entire Eastern Europe. Another political risk is the situation in the Middle East, where many countries have unstable regimes following the Arab spring. Rezidor's south – and eastward expansion has also increased Rezidor's exposure to commodity prices, and most importantly oil prices. Many of

Rezidor's markets are large oil producers, as for instance Russia, Norway, Saudi Arabia, Qatar, the United Arab Emirates, Tunisia, Egypt, Algeria, Angola and Nigeria. There is a risk that we in future will see oil prices remain on low levels, which has a serious effect on GDP and hotel demand in these countries.

The threat of Airbnb has already hit the hotel industry, but may constitute a bigger threat in future, if the next generation chooses to spend less on accommodation. One possibility to tackle this threat is to follow the tactics of Hyatt and Wyndham, who are contesting Airbnb by investing in other home-sharing start-ups. (Zacks, 2016)

Another risk that Rezidor faces is the risk of brand dilution through the misconduct of franchisees. In order to reduce costs, a franchisee might be incentivized to decrease the level of service, which hurts the reputation of Rezidor's brands (Rezidor, 2014b). The franchising agreement that Rezidor has with the brand owner Carlson constitutes another serious threat to Rezidor. Carlson might decide to increase the royalty fees for using the brand names or worse, terminate the partnership upon contract expiry.

6 Section - Financial Analysis

Having defined Rezidor's strategic positioning we will in the following section provide a detailed financial analysis of Rezidor's business. This analysis is important as it portrays Rezidor's key financial drivers as well as its relative position to peers. Due to the abnormal economic conditions in the Rezidor's regions caused by the global financial crisis in 2008-2009 and by the European debt crisis in 2010, we chose a historical period of 5 years for our analysis (2011-2015). First, the reported financial statements of Rezidor and peers will be reformulated into analytical financial statements. Then, a profitability analysis and decomposition of the return on invested capital (ROIC) will be presented. A benchmarking of financial drivers will conclude this section of the thesis.

6.1 Reformulation of Financial Statements

A company's activities can be divided into operating, investing and financing activities. When conducting a financial analysis, it is common to transform the reported financial statements into analytical financial statements, a procedure called reformulation. The main purpose of reformulating financial statements is to illustrate the company's operating and financing activities. Such a reformulation also allows for a more accurate forecasting and a better comparison with the firm's competitors.

The reformulation into analytical financial statements is carried out by separating items belonging to the company's operations from items that belong to the company's capital structure, labelling them operating activities and financial activities, respectively. (Petersen & Plenborg, 2012, p.68). Operating activities are associated with the primary purpose of a business, whereas financing activities are external activities that allow a firm to raise capital and repay investors. A reformulation is typically implemented both on the reported income statements and the reported balance sheets of Rezidor and of its peer companies, resulting in consistent analytical income statements and balance sheets. (ibid, p.68-69) The complete reported and analytical financial statements can be found in Appendix B-F.

6.1.1 Analytical Income Statement

We consider items such as "revenue", "operating expenses"[7], "insurance of properties" and "property tax and rental expense" to part of the company's operating activities. The same holds for "share of income in associates and joint ventures" as Rezidor specifies that such holdings are to facilitate entry into new hotel contracts in their annual reports (Rezidor, 2015a). We choose to label the item "terminating, restructuring and adding contracts" as an operating activity rather than a financing activity, as it relates to Rezidor's portfolio management, which is a key operating activity. Similarly, we allocate "depreciation & amortization", "impairment and restructuring charges" to operating activities. Concerning the latter two items, it would also be possible to allocate these to financing activities. However, as they are recurring expenses throughout the analysis period, we choose to categorize them as operating activities.

Next, we choose to categorize "interest income and expenses" as financial items as they are clearly connected to Rezidor's financial activities. The same logic holds for "interest-bearing debt". "Net loss on early extinguishment of debt", "loss on sale of shares" and "tangible fixed assets" are items that we also consider to be part financial items, as they are the results of non-recurring events. Last, as corporation tax involves both operating and financing items, it is necessary to split the item into tax on operations and tax on financing activities (ibid, p.76). Such a separation can be accomplished by estimating the tax shield. This is done by multiplying the Swedish corporate tax rate with Rezidor's net financial income before tax. (KPMG, 2016)

For the purpose of choosing the right corporate tax rate, Petersen & Plenborg (2012) recommend the use of either the country-specific corporate tax rate or the historical average

[7] Expenses such as costs of goods sold for food & drink, personnel costs and contract labour.

effective tax rate as a proxy for the corporate tax. The effective tax rate is calculated as the reported tax for the year divided by the profit before tax (ibid, p.73). We choose to apply the corporate tax rate rather than the historical effective tax rate because Rezidor's effective tax rate has in the last years been unusually high, averaging 45% in the years between 2011 and 2015. Alternately, we decide on using the current Swedish corporate tax of 22%.

Having derived Rezidor's tax shield, we can separate the tax on operating activities from the tax on financing activities. By adding the tax shield to the reported tax we obtain Rezidor's tax on operations. Adding tax on operations to EBIT leaves us with NOPAT. NOPAT is of particular interest for investors, as it displays a more accurate and comparable view of operating efficiency, excluding the tax benefits that companies get from bearing leverage. Lenders on the other hand typically regard NOPAT as the company's primary source for debt service. (ibid, p.70)

6.1.2 Analytical Balance Sheet

One important aspect to highlight at this point is that there has to be similarity between the analytical income statement and the analytical balance sheet. For this reason, items classified as operating on the income statement, thereby being part of NOPAT, have to be classified as operating items on the balance sheet as well, and be included in the calculation of invested capital (Petersen & Plenborg, 2012, p.76). Accordingly, we classify "investments in associated companies and joint ventures" as operating assets.

We choose to classify "pension funds", "interest-bearing receivables", "cash and derivative financial instrument" as financial items, since they are part of the total interest-bearing assets. Furthermore, we label assets such as "license & related rights", "machinery & equipment" and "non-interest-bearing receivables", as operating assets. We consider "deferred tax assets" to be part of operations since these assets are non-interest-bearing (Petersen & Plenborg, 2012, p.79). Having defined the operating assets, we are able to separate these into current operating assets and non-current operating assets, where the former refers to assets that can be converted to cash within a year.

Turning to the liabilities on the balance sheet, we treat "long-term" and "current portion of long-term debt" as financial activities because they are interest bearing and relate to the long term financing of the company (ibid, p.75). We further allocate the item "derivative financial instruments" to financing activities as it is used for hedging financial risks (ibid, p.78). Next, we regard the item “liabilities classified as held for sale” to be a financial liability as it relates to discontinued operations, meaning that they do no longer form part of a company’s core operations. As for “retirement benefit obligations” we consider the item to be a financial liability as it is interest-bearing. (ibid, p.78-79) We treat both accounts payable and provisions as operating items and since we earlier classified deferred tax assets as operating item, we will treat differed liabilities likewise. (Rezidor, 2015a). Last, we consider “equity”, “reserves”, “retained earnings” and “minority interest”, representing the total equity, as financial items as they are clearly linked to Rezidor’s capital structure.

The reformulation of the analytical balance sheet allows us to calculate the invested capital, both for operating assets as well as for financial assets. Invested capital can be defined and calculated by various methods, but as we based our calculations on the framework of Petersen & Plenborgs (2012), the following formulas were used.

(2) $$Total\ Operating\ Assets - Non\ Interest\ Bearing\ Debt = Invested\ Capital\ (Operating\ Assets)$$

(3) $$Total\ Equity + Net\ Interest\ Bearing\ Debt = Invested\ Capital\ (Financial\ Assets)$$

6.2 Profitability Analysis

Having created analytical financial statement of both Rezidor and its peer group, we can now proceed to the profitability analysis. Analyzing profitability is a key aspect of the financial analysis, as it shows signs of a company’s competitive advantage and long-term survival (ibid, p.93). By ensuring a healthy level of profitability, a company will be able to service its responsibilities towards shareholders, creditors and other stakeholders attached to the firm. The historical trend in profitability is an important element to address, as it contains information about whether the current level of profitability can be deemed satisfactory compared to peers as well as displaying the company’s ability to improve its profitability over time. Such information serves an important role in establishing a view on a company’s future economic prospects in order to formulate realistic forecast assumptions when conducting valuations. (ibid, p.93-94)

6.2.1 Return on Invested Capital

Return on invested capital (ROIC) is a fundamental measure of operational efficiency and the overall profitability. All else equal, a higher ROIC yields a higher valuation of the company in question. A higher ROIC also impacts the company’s lending terms positively as creditors find it more attractive to provide financing for companies with higher ROIC. (ibid, p.94)

The ratio can be calculated on a pre or post-tax basis and displays the relationship between a company's operating income and its invested capital. Since the peers are geographically dispersed, having different countries of residence, they are also subject to different corporate tax rates. To control for this difference, we are therefore analyzing ROIC on a pre-tax basis[8], using average values for invested capital, which according to Petersen & Plenborg (2012, p. 96) represents the most accurate measure. The ROIC can also be calculated by multiplying the profit margin with the turnover rate of invested capital. A breakdown of both the profit margin and the turnover rate of invested capital will follow in the next sections.

(4) $$ROIC\ (before\ tax) = \frac{EBIT}{Invested\ Capital}$$

Exhibit 28 presents the levels of ROIC on a pre-tax basis. By looking at the peer average levels of ROIC, we can identify a healthy development of the ROIC throughout the period. IHG clearly emerges as best-in-class reaching an average of 86% during the period. Such high levels of ROIC and operational profitability are explained by the particularly asset-light and high-margin business model of IHG's, having the highest fraction of franchise and managed hotel contracts among all peers. Similar to IHG, also Marriott has experienced a higher ROIC in each year than the peer group average.

Concluding from the ROIC assessment, with reservation for minor discrepancies in business models and related capital intensity, we infer that Rezidor's level of profitability is below that of IHG and Marriott, in line with Starwood's and higher that Hiltons. Thus, it appears as if Rezidor has the potential to reach a higher degree of value creation under a PE funds ownership by pursuing a strategy inspired by IHG's and Marriott's achievements.

Exhibit 28. Return on Invested Capital

Return on Invested Capital (Average Values)						
Before Tax	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-3.0%	-0.6%	29.7%	19.4%	32.7%	**15.6%**
IHG	64.0%	67.0%	81.5%	102.8%	115.7%	**86.2%**
Starwood	15.8%	21.2%	22.9%	23.7%	26.1%	**21.9%**
Hilton	-	6.9%	6.9%	12.2%	12.4%	**9.6%**
Marriott	21.4%	45.7%	45.3%	57.1%	86.1%	**51.1%**
Average	**24.6%**	**28.0%**	**37.3%**	**43.0%**	**54.6%**	**-**

Source: Company annual reports, Own creation

The ROIC gives an indication of the company's overall level of profitability however without distinguishing where it is derived. Generally, the level of ROIC is driven by favorable generation

[8] Post-tax ROIC is displayed in Appendix H.

of operating income in relation to sales, or by efficient utilization of invested capital (ibid, 2012, p.107). To find the underlying factor behind a change in ROIC it is thus beneficial to decompose it into profit margin and turnover rate of invested capital, which will be analyzed next.

6.2.2 Profit Margin

The profit margin can be calculated on a pre and post-tax basis, and shows the percentage of the selling price that is turned into profit. A high profit margin is attractive, as it indicates that a company is more efficient, essentially generating more profit for each unit of sales. (ibid, 2012, p.107)

(5) $$Profit\ Margin\ (before\ tax) = \frac{EBIT}{Sales}$$

As our peer companies are subject to difference corporate tax rates, we choose to conduct this analysis based on the pre-tax basis, in other words we will be looking at the EBIT-margin. Exhibit 29 shows the profit margin of Rezidor and the peer group before tax. The table indicates that Rezidor's average profit margin over the period has been significantly lower with respect to its peers. The negative profit margins of 2011 and 2012 are explained by the difficult macroeconomic conditions in Western Europe during the European Debt crisis. While this reason holds for 2011 and 2012, it is fails to explain the general picture of Rezidor's margins being significantly below the peer average. As noted earlier, Rezidor's operates a business model containing a larger share of leased hotels than its peer competition. On average, leased hotels generate much lower profit margins than franchised or managed hotels. Rezidor has since the launch in 2012 of the turnaround strategy "Route 2015" increased its share of franchised and managed hotels - an important reason why the company for each year is generating higher profit margins. Route 2015 has also focused on other measures that have generated higher revenues as well as reduced operating costs, leading to increased profit margins. By the end of 2015, Rezidor estimated that Route 2015 on its own accounted for an increase of 7.7% in EBITDA margin[9].

Analyzing the peer group, IHG displays a stable development in its profit margin, partly explained by having the lowest share of leased hotels between 2011 and 2015. Starwood reported the second highest average profit margins, which is remarkable, considering that their business model is the closest to Rezidor's. Despite some small fluctuations, Hilton experienced a decline in profit margin over the five-year period. This development can be explained by

[9] The reader should be aware that the EBITDA is not the same as the profit margin (EBIT margin), but the two ratios are very closely related.

Hilton's extensive expansion strategy, where focus has been to increase volumes rather than profitability. Last, Marriott has reported a positive development of their profit, albeit starting from lower levels.

Exhibit 29. Profit Margin

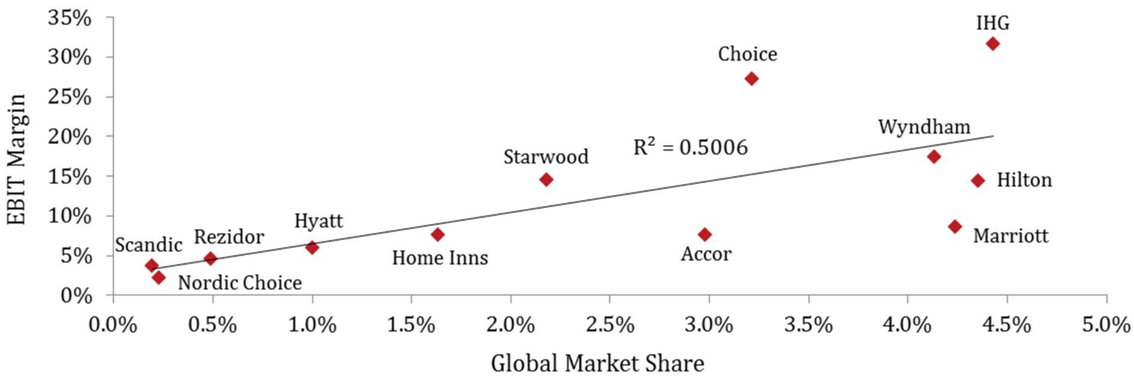
Profit Margin						
Before Tax	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-0.9%	-0.1%	4.8%	3.3%	5.7%	**2.6%**
IHG	31.0%	32.9%	35.1%	35.1%	37.8%	**34.4%**
Starwood	11.4%	14.4%	15.1%	14.6%	13.4%	**13.8%**
Hilton	9.6%	12.2%	11.1%	16.7%	15.5%	**13.0%**
Marriott	4.1%	8.2%	7.8%	8.5%	9.6%	**7.6%**
Average	**11.0%**	**13.5%**	**14.8%**	**15.6%**	**16.4%**	**-**

Source: Company annual reports, Own creation

Observing the column on the far right of exhibit 29, we can see that Hilton, Starwood and IHG over the past 5 years consistently have generated satisfying profit margins. These high and consistent profit margins are a little surprising, as the industry is characterized by intense competition, with a rather low degree of concentration. However, we have earlier concluded in section 5.3.1 that scale efficiencies are present in the industry and become more important in the form of increased brand loyalty among customers and lower overhead costs. We have also concluded in section 4.5.2 that the industry is undergoing a period of increased consolidation, both through mergers & acquisitions, as with the Marriott-Starwood merger, as well as through organic growth, as with Hilton's heavy international expansion. These signs make it interesting to investigate, whether firm size has a significant effect on profitability, as measured in EBIT/Sales.

To examine this notion, we calculated average EBIT-margins and market shares for selected hotel operators between 2012 and 2015. We had to be selective on which companies to include, because many of the top 20 hotel operators are not publicly listed and do not publish financial information. We also decided to exclude a few companies from our sample that also have other revenue streams than purely hotel operations, such as Mövenpick (also a large producer of ice cream). Our final sample contained 12 international hotel operators, originating from three different continents. As this sample is too small for running a regression analysis, we decided to plot the relationship in a scatter diagram, as displayed in exhibit 30.

Exhibit 30. Relationship between EBIT/Sales and Market Shares



Source: Company annual reports, Own creation

The graph shows that there is a relationship between profitability and firm size in the hotel industry. However, it seems that the relationship is stronger for firms with lower sizes, than for the very large players in the industry. The statistical correlation is demonstrated by the R^2 of 0.5006 and by a two-tailed p-value of 0.00187. However, we have to bear in mind that it is likely that the causality between these two variables is suffering from selection bias as well as omitted variable bias. As for the issue of endogeneity, we believe that EBIT/Sales correlates with the choice of business model, which we touched upon earlier in this section, discussing the fact that IHG was able to generate a higher profit margin, thanks to its high share of franchised hotels.

Concluding the profit margin analysis, we can say that it is evident that Rezidor has been generating lower rates of profitability compared to its peers, due to a different business model and lower firm size.

6.2.3 Turnover Rate of Invested Capital

The turnover rate of invested capital describes a company's ability to use invested capital. The higher the turnover rate of invested capital, the better is the firm at generating sales given the resources it has invested in its operations. (Petersen & Plenborg, 2012, p. 108)

(6) $$Turnover\ Rate\ of\ Invested\ Capital \quad \frac{Sales}{Invested\ Capital}$$

Comparing Rezidor's turnover rate of invested capital with its peer group, it is evident that Rezidor has been deploying its invested capital more efficiently than all peers, except Marriott. However, Rezidor's turnover rate of invested capital is showing a decreasing pattern over the five-year period. The decline is explained by an increase in invested capital, driven by relatively large investments in order to improve its hotel standards. (Rezidor, 2015a)

Marriott is the only company in the peer group, with a turnover rate exceeding Rezidor's in 2014 and growing even larger in 2015. The underlying explanation behind this increase relates to assets disposals which reduced Marriott's amount of invested capital. Adjusting for these disposals, the turnover rate of invested capital did still increase in 2014 and 2015, however at a more modest pace (Marriott, 2015).

Exhibit 31. Turnover rate of Invested Capital

Turnover rate of Invested Capital (Average Values)						
Before Tax	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	5.8 x	6.3 x	6.2 x	5.9 x	5.7 x	**6.0 x**
IHG	1.9 x	2.0 x	2.3 x	2.9 x	3.1 x	**2.4 x**
Starwood	1.2 x	1.5 x	1.5 x	1.6 x	1.9 x	**1.6 x**
Hilton	0.5 x	0.6 x	0.6 x	0.7 x	0.8 x	**0.7 x**
Marriott	6.3 x	5.6 x	5.8 x	6.7 x	9.0 x	**6.7 x**
Average	**3.2 x**	**3.2 x**	**3.3 x**	**3.6 x**	**4.1 x**	**-**

Source: Company annual reports, Own creation

6.2.4 Summary of the Profitability Analysis: Decomposing ROIC

To conclude the profitability analysis, IHG emerges as the market leader in terms of profitability, while Marriott is the runner up. However, we could see that the two companies have reached their respective position by taking different paths. Whereas IHG has consistently reported outstanding profit margins, Marriott has been successful at improving its turnover of invested capital. Rezidor's ROIC has on average been higher than Hilton while being on par with Starwood. Rezidor has proven to be efficient at deploying its invested capital, while having the lowest margins of the peer group. However, thanks to Route 2015, Rezidor has managed to improve its profit margins, but there is still considerable room for improvements. The most obvious solution is to increase the share of fee-based contract agreements in Rezidor's hotel portfolio. Another way to improve its profit margins is by increasing market shares in order to achieve economies of scale and scope.

6.3 Benchmarking of Financial Drivers

Having examined Rezidor's profitability, we will in the following section analyse Rezidor's key financial value drivers benchmarked against the peer group. The purpose of conducting this analysis is to identify financial aspects in which Rezidor could improve. We will conduct the benchmarking analysis by comparing the development in revenues, EBITDA margin, working capital, capex and net debt to EBITDA. Thereafter, we will analyse Rezidor's regional and segmental revenues, as well as Rezidor's EBITDA margin development. All financial data is compared on a local currency basis in order to minimize the exchange rate effects and thereby isolating the development in operational performance.

6.3.1 Revenues

Exhibit 32 shows the development in revenues for the peer group. From this table we can infer that the industry trend, expressed in bold text in the bottom line, does not provide a representative picture for individual firms. This is because the individual revenue growth rates deviate considerably from the peer average. Hence, we have to analyze the revenue growth rates from each firm separately.

We earlier noted, Rezidor's business model contains relatively more leased hotels compared to its peer competition (Appendix G). Although leased hotels only correspond 20% of Rezidor's hotel portfolio, they account for 85% of Rezidor's revenues, and 40% of Rezidor's EBITDA. As long as Rezidor has such a high share of leased hotels in its portfolio, this means that Rezidor's revenues are to a very high extent is driven by the revenues generated by the leased hotels. Almost all of these leased hotels are located in Rezidor's traditional markets: The Nordics and the rest of Western Europe. Thus, we can conclude that Rezidor's revenue growth mirrors the RevPAR development in two of its four regions, making it very difficult to relate to its peers.

Instead, the revenue growth of IHG, Hilton and Starwood, who have a nearly negligible share of leased hotels, is driven by the fees collected from their franchised and managed hotels. As only a small part of these are variable fees[10], most of the growth in sales of IHG, Hilton and Starwood is thereby generated by new hotel openings or as in the case of Hilton, the renegotiation of contracts, resulting in more favorable terms. Going forward, we can conclude that conducting a benchmarking analysis on revenue growth is difficult, due to the large differences in business models between Rezidor and its peer companies.

Exhibit 32. Development in Revenues

Revenue Growth						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	10.0%	6.8%	-0.5%	1.6%	6.8%	**5.0%**
IHG	8.6%	3.9%	3.6%	-2.7%	-2.9%	**2.1%**
Starwood	10.9%	12.6%	-3.2%	-2.1%	-3.4%	**2.9%**
Hilton	8.9%	7.3%	5.2%	7.9%	7.4%	**7.3%**
Marriott	5.4%	-4.1%	8.3%	8.0%	5.1%	**4.5%**
Average	**8.7%**	**5.3%**	**2.7%**	**2.5%**	**2.6%**	**-**

Source: Company annual reports, Own creation

[10] By variable fees, we mean revenues that are dependent on the earnings made by the hotel property owners.

6.3.2 EBITDA margin

In the previous section we concluded that revenue growth is not a good measure to compare companies with different business models. Instead, we believe that EBITDA is a better measure of cash flows to benchmark, because it incorporates the large costs and operating expenses incurred by leased hotels and therefore reduces impact of the choice of business model. More specifically, we will use EBITDA as percentage to sales to benchmark Rezidor's operating margins with its peer group.

(7) $$EBITDA\ margin = \frac{EBITDA}{Sales}$$

Exhibit 33 illustrates the development of EBITDA margins for Rezidor and its peer companies. All companies, including Rezidor, have throughout the historical period improved their EBITDA margins, signalling that the industry is healthy, at least for the largest players. Specifically, IHG, Starwood and Hilton managed to increase their EBITDA margins, although they were high to begin with in 2011.

As for Rezidor's EBITDA margin development, the efforts from "Route 2015" become evident, as the company achieved an increase of 6.1% during the period. Despite this sound improvement, Rezidor's EBITDA margin is still considerably lower than peers. Thus, it appears as if Rezidor has room for improvements in terms of profitability and EBITDA margin. However, it is important to bear in mind that there is still some discrepancy in EBITDA margins related to Rezidor's choice of business model, compared to the peer group. Hence, decreasing the share of leased hotels would also result in higher EBITDA margins. Given our discussion in section 6.2.2, it is plausible that higher market power would lead to economies of scale, which is a way of reducing costs, in turn improving EBITDA margins.

Essentially, we conclude that as a result of strategic measures targeting profitability Rezidor has managed to improve its EBITDA margin with a magnitude in line with peers over a five-year period. Nonetheless, as Rezidor's EBITDA margin still is at a level considerable lower than peers, we see further room for marginal expansion possible in the years ahead. Given Rezidor's success in improving profitability in the recent years in combination with the positive marginal development of peers, such continuously positive development should be possible to maintain.
Thus, with regards to the EBITDA margin, we infer optimistic premises about Rezidor's economic prospects in the years ahead.

Exhibit 33. Development in EBITDA Margin

EBITDA Margin						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	4.0%	5.5%	8.8%	7.6%	10.1%	**7.2%**
IHG	36.6%	38.0%	39.5%	40.3%	43.1%	**39.5%**
Starwood	17.3%	18.5%	19.9%	19.8%	20.0%	**19.1%**
Hilton	16.4%	18.3%	17.6%	22.1%	22.0%	**19.3%**
Marriott	6.8%	7.9%	7.7%	9.5%	10.4%	**8.4%**
Average	**16.2%**	**17.6%**	**18.7%**	**19.9%**	**21.1%**	**-**

Source: Company annual reports, Own creation

6.3.3 Operating Working Capital

Working capital is a measure of liquidity and short-term financial health as it shows the company's ability to meet its current liabilities with the current assets it has at its disposal (ibid, p.153-154). Working capital is defined as the difference between a company's current assets and its current liabilities, which is important to considerate in the forecast of free cash flows.

(8) $$Operating\ Working\ Capital = Operating\ Current\ Assets - Operating\ Current\ Liabilities$$

When analyzing working capital for valuation purposes, it is common practice to exclude activities related to a company's financing activities, such as "cash", "short-term investments" and "interest-bearing debt" (Damadoran, 2005). We therefore apply the operating working capital (OWC) defined as the difference between current operating assets and current operating liabilities. PE firms are typically experts at improving the efficiency and reducing the working capital when undertaking LBOs. A lower level of working capital will, all else held equal, increase the amount of free cash flow available for debt payments which is a key element in the LBO transaction.

From exhibit 34, we can observe that Rezidor, as well as its peer group reported negative OWC all years, except from Starwood in 2011. Moreover, by looking at the bottom row, we see that the average trend indicates an increasingly negative relationship. As with Starwood in 2012, working capital can become negative as a result of a large one-time cash payment or other sudden reductions in current assets or increases in current liabilities. (Starwood, 2012) Taking a closer look at the development of current assets and current liabilities of the peer group companies, we can infer that all peers have been reducing their inventories over the period. Starwood has been the most active peer in this regard, shrinking its inventory immensely by a compounded annual average of -20%. Rezidor, on the other hand, has not followed this trend, but has instead increased its inventory by 1.4% as measured in compounded annual growth rate. From this we can conclude that there is a potential for Rezidor to keep OWC low by reducing the inventory.

According to Damodaran (2005), it is not uncommon that the OWC is negative and varies between companies within the same industry. In a sense, a negative OWC means that the company is able to obtain debt free financing from creditors and suppliers. From an accountant's perspective however, negative OWC is often regarded as a potential default risk, and thus it should be considered with the specific business model in mind. (Damadoran, 2005)

Exhibit 34. Operating Working Capital as % of Sales

Operating Working Capital (as % of Sales)						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-6.5%	-4.9%	-5.2%	-4.4%	-5.3%	**-5.3%**
IHG	-25.2%	-16.7%	-18.8%	-19.5%	-26.1%	**-21.3%**
Starwood	5.3%	-1.7%	-3.7%	-6.8%	-10.2%	**-3.4%**
Hilton	-1.3%	-3.0%	-5.8%	-3.0%	-3.6%	**-3.3%**
Marriott	-2.7%	-2.0%	-3.3%	-4.7%	-5.9%	**-3.7%**
Average	**-6.1%**	**-5.7%**	**-7.4%**	**-7.7%**	**-10.2%**	**-**

Source: Company annual reports, Own creation

6.3.4 Capex

When forecasting free cash flows, capex is an important aspect to consider as it represents cash transactions. Capex are expenses related to purchases, upgrades or maintenance of a company's physical base of assets. By making such investments, companies can increase their future efficiency and scope of their operations. In the context of LBO's, PE firms commonly assume that annual capex equals annual depreciation and amortization, thus keeping the asset base at a constant level. Depending on the situation however, capex could be assumed to accelerate or decelerate as well. (Stowell, 2010, p.312)

Exhibit 35 shows the level of capex in relation to sales for the peer group. The table shows that Rezidor between 2011 and 2015 has invested at a higher level than its peers. The investments have been related to renovations of Rezidor's leased hotel portfolio in the rest of Western Europe and Nordic region as well as new investments in the Middle Eastern & African region. (Rezidor, 2015)

Although showing some fluctuations, the overall trend among the peer companies is a small decrease in capex over the time period. Thus, we infer that there is a potential for Rezidor to decelerate its capex going forward, as a mean of amplifying the level of free cash flows.

Exhibit 35. Capex as % of Sales

Capital Expenditures (as % of Sales)						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-4.3%	-4.3%	-5.2%	-5.4%	-7.1%	**-5.3%**
IHG	-3.1%	-2.4%	-8.3%	-4.5%	-2.3%	**-4.1%**
Starwood	-6.8%	-5.7%	-5.9%	-5.4%	-4.5%	**-5.7%**
Hilton	-4.5%	-4.7%	-2.9%	-2.5%	-2.7%	**-3.5%**
Marriott	-1.5%	-3.7%	-3.2%	-3.0%	-2.1%	**-2.7%**
Average	**-4.0%**	**-4.2%**	**-5.1%**	**-4.2%**	**-3.8%**	**-**

Source: Company annual reports, Own creation

6.3.5 Net Debt

Leverage is determined by the level of net debt in relation to EBITDA, where a higher ratio indicates a higher level of leverage. The multiple shows how many years it takes to pay off the net debt given that EBITDA remains constant. (Rosenbaum & Pearl, 2009, p. 38)

(9) $$Net\ Debt = Interest\ Bearing\ Liabilities - Interest\ Bearing\ Assets$$

From exhibit 36, we can conclude that the peer group uses a substantially higher level of leverage than Rezidor. In contrast to the peer companies, Rezidor has reported a negative net debt throughout the estimation period, meaning that Rezidor has held more cash than debt on its balance sheet and has therefore operated on a lower risk. Rezidor's net debt decreased quite substantially in 2014 as a result of the rights issue, which enabled Rezidor to increase its equity and cash positions, as described in section 4.41.

Observing the development of Rezidor's peer companies, we can see that all peers, except from Hilton, have maintained about the same net debt to EBITDA ratios over the last five years. Hilton's high leverage is explained by the fact that it was an LBO target until 2013. As we have earlier explained, it is common in LBO transactions to take up high levels of debt and gradually pay it back in the years that follow. We conclude from this information that, Rezidor has been holding a more conservative financial structure compared with its peers. Given that a higher ratio of net debt to EBITDA is observed among peers, Rezidor should have good possibilities to increase its level of debt and leverage in the future. Tax shield advantages associated with such an increase in leverage could create value by lowering Rezidor's effective tax rate.

Exhibit 36. Net Debt to EBITDA

Net Debt/EBITDA						
Company	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-0.5 x	0.0 x	-0.1 x	-0.7 x	-0.6 x	**-0.4 x**
IHG	0.6 x	0.8 x	1.1 x	1.6 x	0.5 x	**0.9 x**
Starwood	1.6 x	0.8 x	0.5 x	1.6 x	1.1 x	**1.1 x**
Hilton	10.4 x	8.3 x	6.4 x	3.7 x	3.6 x	**6.5 x**
Marriott	3.2 x	3.9 x	3.6 x	3.2 x	3.2 x	**3.4 x**
Average	**3.1 x**	**2.7 x**	**2.3 x**	**1.9 x**	**1.6 x**	**-**

Source: Company annual reports, Own creation

6.3.6 Segment Analysis

In order to gain a deeper understanding of Rezidor's financial development and drivers, we will in this section analyze revenue growth and EBITDA margin by region and contract type. Exhibit 37 and 39 show the sources of revenues and EBITDA between 2011 and 2015. From this information it is needless to say that the majority of Rezidor's revenue is derived from the Nordic and Rest of Western Europe region. Moreover, most regions display a fairly constant level over time. As an exception, the Middle East and Africa region indicate an increasing trend however still only compromising a minor part of the total revenues. In terms of business model, the lion share of revenues is collected from leased hotel contracts with managed and franchised contracts increasing their shares at a modest pace.

Exhibit 37. Rezidor's Revenue by Region and Contract type

Revenue Growth Breakdown						
Segment	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
By Region						
Nordics	-	7.9%	-1.3%	4.0%	0.6%	**2.2%**
Rest of Western Europe	-	3.7%	-0.9%	1.3%	11.6%	**3.1%**
Eastern Europe	-	19.0%	3.8%	-10.2%	3.1%	**3.1%**
Middle East & Africa	-	41.0%	16.5%	-3.3%	18.5%	**14.5%**
By Contract Type:	-					
Leased	-	5.7%	-1.9%	3.3%	4.9%	**2.4%**
Managed	-	17.7%	8.4%	-8.3%	14.4%	**6.5%**
Franchised	-	11.1%	24.6%	-1.3%	13.9%	**9.6%**

Source: Rezidor (2011a-2015a), Own creation

In the context of each region's and contract type's share of total EBITDA, exhibit 38 presents a slightly different view. For instance, the Rest of Western Europe region which was Rezidor's largest market as determined by share of revenues, only represents the third largest share of EBITDA. Instead, the Nordics and Eastern Europe contribute the most in terms of EBITDA. Regarding the contract types of Rezidor, we can see that leased hotels decline in importance as a share of EBITDA. On average, leased hotels contributed to 86% of total revenues, but as a percentage of total EBITDA, they only represented 39% over the five-year period. Instead, managed contracts have become increasingly important as they on average constituted 47% of the total EBITDA.

Exhibit 38. Rezidor's EBITDA by Region and Contract type

EBITDA Share of Total						
Segment	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
By Region						
Nordics	57.7%	52.2%	45.2%	45.3%	32.8%	**46.6%**
Rest of Western Europe	5.3%	8.0%	21.9%	21.4%	37.5%	**18.8%**
Eastern Europe	24.6%	25.7%	19.0%	20.0%	15.2%	**20.9%**
Middle East & Africa	12.3%	14.1%	14.0%	13.3%	14.6%	**13.7%**
By Contract Type:						
Leased	39.3%	39.2%	39.8%	38.1%	40.2%	**39.3%**
Managed	48.0%	48.1%	47.5%	46.8%	44.6%	**47.0%**
Franchised	8.6%	8.6%	10.0%	8.4%	8.2%	**8.8%**

Source: Rezidor (2011a-2015a), Own creation

Considering a breakdown of the EBITDA margin, exhibit 39, shows EBITDA margins by regions and contract types. The Rest of Western Europe and Middle East and Africa point toward a stable trend with solid growth levels over time. As we saw in exhibit 23, Rezidor has reported a similarly stable RevPAR in both regions over the time period a fact that explains the growth in EBITDA margins. Similarly, the stagnating EBITDA margins of Rezidor's Nordic and Eastern European hotels, can be explained by exhibit 23, where Rezidor during the time period experienced an unchanged development in RevPAR.

As for the different contact types, leased and managed contacts experienced consistent improvements as a result of the recent strategic measures undertaken by Rezidor to facilitate improved cost efficiency and profitability, as addressed in section 6.2.2. Franchised contracts displayed a more volatile trend and were essentially unchanged over time. (Rezidor, 2015a)

Exhibit 39. Rezidor's EBITDA Margin by Region and Contract

EBITDA Margin Breakdown						
Segment	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
By Region						
Nordics	12.2%	12.1%	13.2%	12.1%	11.5%	**12.2%**
Rest of Western Europe	1.1%	1.8%	6.2%	5.7%	11.9%	**5.3%**
Eastern Europe	67.4%	69.4%	61.7%	68.9%	67.0%	**66.9%**
Middle East & Africa	61.2%	58.2%	62.1%	58.0%	70.9%	**62.1%**
By Contract Type:						
Leased	5.1%	4.8%	6.2%	5.5%	7.3%	**5.8%**
Managed	61.9%	52.5%	59.8%	61.0%	67.4%	**60.5%**
Franchised	55.8%	50.2%	58.4%	47.0%	53.4%	**53.0%**

Source: Rezidor (2011a-2015a), Own creation

6.4 Financial Analysis Summary

The profitability analysis and benchmarking of Rezidor's financial drivers showed that Rezidor has managed to improve its return on invested capital substantially in the most recent years. Nevertheless, Rezidor still underperform its peers with relation to ROIC, which is mostly due to a lower profit margin. Hence, by maintaining the high turnover rate of invested capital and implementing measures to improve its profit margin, Rezidor would be able to generate a higher profitability going forward. Potential measures that we have identified in this financial analysis have been a reduction of leased contracts as well as an increase in firm size.

In terms of EBITDA margin, Rezidor is despite a promising development in the last years still quite far behind the levels of three out of four competitors, leaving Rezidor with room for improvement. Similarly, we identified that there is a small potential to improve the deployment of working capital and capex. Given that Rezidor has shown a lower net debt to EBITDA multiple relative to its peers, there is also room for increased leverage, which would generate a higher tax shield. To conclude, Rezidor's financial development appears to be going in the right direction as a result of the strategic changes undertaken in the recent years.

7 Section – Forming the Business Plan

As depicted in 3.1, a typical LBO transaction process involves a business plan describing the possibilities for value creation of the LBO candidate. Having analysed Rezidor both strategically and financially, we will in this section use our findings to formulate a business plan for Rezidor. First however, we find inspiration by looking at the most profitable LBO transaction in history, which happens to be in the hotel industry: Blackstone's leveraged buyout of Hilton Worldwide.

7.1 Best Practice Case– Blackstone's LBO of Hilton Worldwide

On Oct. 24th 2007, the PE company Blackstone closed the landmark acquisition of Hilton Worldwide, the second largest hotel operator in the world. More than 6 years later, on December 11th, Blackstone reintroduced Hilton on the New York Stock exchange, making a profit of $12 billion. (Health, 2014) The question is, how was this value created? Besides the favourable market timing of Hilton's IPO, we will in the following sections provide some concrete examples of how Blackstone created value. These examples are labelled, as in section 3.3, as financial, governance and operational engineering.

7.1.1 Financial Engineering

The initial purchase price in the leveraged buyout of Hilton amounted to $26 billion, of which $5.6 billion was equity invested by Blackstone. Already two years later, in 2009, Hilton reported a 15% drop in revenues due to the tumbling demand, forcing Blackstone to write off 70% of its equity value. In order to save the company, Blackstone met with the banks that held the $20.4 billion in debt. They reached a deal in which Blackstone committed to buy back some of the debt at a discount of 54%. Other lenders converted their debt into preferred equity, which they could sell in an eventual IPO. Also, the new deal resulted in an extension of the maturity of the remaining debt until 2015. (Cohan, 2014)

7.1.2 Governance Engineering

Central to Blackstone's plan to improve Hilton was the recruitment of new management. According to a hotel analyst, Hilton suffered prior to the LBO transaction from idle management, or as the analyst put it: "The executives didn't work all that hard. There are numerous stories about these guys not taking that company to the next level." (Health, 2014) Blackstone decided to recruit a new CEO in the form of Christopher Nasetta, who had almost 30 years of experience in the hotel industry. Before joining Hilton, he was the CEO of Host Hotels, where he was awarded "the Institutional Investor's 2007 REIT CEO of the Year." (Hilton, 2013b) Part of the motivation behind hiring Nasetta was his background as a restructuring expert. He was formerly successful in turning around broken companies, such as Oliver Carr, Antonelli Group and Host Hotels. (Health, 2014)

7.1.3 Operational Engineering

Rebalanced business model: Between 2007, when Hilton was taken private, and 2013, when Hilton was reintroduced on the New York Stock Exchange, Hilton grew its total room count by 34%, the fastest growth rate of the industry. 99% of these were managed or franchised rooms, implying a new balance of Hilton's business model: The share of owned or leased hotel rooms decreased during this period from 13.5% to 9.4%. The low investment needs for this type of expansion were an important factor behind Hilton's improved ability to generate cash flows. Between 2008 and 2012, Hilton was able to increase its cash flows from operating activities from $219 million to $1.1 billion. (Hilton, 2013)

Expansion in targeted markets and segment: Furthermore, most of Hilton's rapid expansion took place in foreign markets and in market segments with high RevPAR growth rates. The most prominent example is the Chinese market, where Hilton increased its number of hotels from 6 to 160, many of these in the mid-scale segment. (Hilton, 2013)

Improved loyalty program and by extension increased customer spending: Throughout the time Hilton was privately owned, Hilton became successful at creating a loyal customer base, much of which a result of its attractive loyalty program, HHonors. Hilton devoted millions of dollars on technology to improve the program, making it easier for customers to spend the points they had accumulated during their stays. (Health, 2014) Consequently, memberships of HHonors grew by an average of 13% per year. In 2013, HHonors members represented almost 50% of Hilton's occupancy and consumed on average four times more than the regular non-HHonors customer. (Hilton, 2013)

Organizational change: Hilton's new leadership soon identified the organizational structure to be counterproductive, upon which it implemented a number of measures. Prior to the LBO takeover, Hilton was organized around five independent business units spread across the United States, with headquarters located in Beverly Hills. This corporate structure carried major overlapping activities; for example, each business unit had its own IT, HR, finance and legal department. Hilton's management decided to take actions to improve integration, for example a uniform system for employee performance assessments was put in place. Another major decision was a relocation of the corporate headquarters to McLean, Virginia, only a 30-minute drive to Washington, where many competitors are located. (Health, 2014) The move from California to Virginia meant that the company would be able to attract more qualified employees, as well as a drop in state corporate income tax from 8.84% to 6.0%. (Weiss, 2014)

7.2 Business Plan

Based on the above-mentioned levers imposed by Blackstone in their transformation of Hilton and past information provided in the strategic and financial analyses, we will in the following sections outline the business plan. The reader should be aware that we have identified these measures given the publicly available information, making it important to bear in mind that companies rarely disclose their weaknesses.

In reality, PE companies conduct due diligence analyses about their target firm based on information that is often not disclosed to the public and they are therefore in a better position to form a concrete business plan. With that said, we believe that there is more room for improvement in the case of Rezidor than presented in our business plan, and we therefore have a more conservative forecast than what possibly would be the case in reality.

7.2.1 Financial Engineering

Increased tax shield. Financial engineering will serve as a key value creator in the LBO by optimizing Rezidor's financial structure. As addressed in section 6.3.5, Rezidor has historically maintained lower levels of leverage compared to peers. This has resulted in higher tax payments than what could be deemed optimal. By increasing the amount of debt on Rezidor's balance sheet, associated interest payments would yield significant tax shield advantages. Thus post the LBO, Rezidor will pay much less tax than it would have otherwise amplified by the debt increase.

7.2.2 Governance Engineering

Optimize board composition and executive compensation. Looking at the current management of Rezidor, it is clear that the company has very close ties to its owner, Carlson Group. In the Rezidor's current board of directors, four out of nine board members have a background in Carlson, whereas two out of seven in the executive board are former Carlson employees, including the CEO Wolfgang Neumann. Given this close connection to the owners, one can ask if it has affected the outcome of the negotiation of the franchise agreement concerning the EMEA user rights of Carlson's brands.

Above that, the composition of the board of directors as well as the executive committee seems to be well balanced, considering the diversity and expertise. However, even though Rezidor on paper seems to in good hands, we believe that the imposition of an LBO transaction requires a change of management. The Hilton example showed that it is not only important to recruit people that are experienced with LBO transactions, but also people that are known for being tough negotiators. This was the case of Jonathan Gray, who successfully renegotiated the terms of the loans. Another fresh breeze to Hilton's management was Christopher Nasetta, who was known for being an expert in restructuring companies and took on his role as CEO by implementing new ideas that proved to be vital for Hilton's success. This is a major advantage with changing leadership, as new leaders are better suited for viewing the company objectively and questioning old structures.

Last, we believe that the very nature of a leveraged buyout itself will discipline management, as they have to be committed to pay the fixed interest payments and amortizations of the loans. Failure to meet the debt obligations will not only leave the company bankrupt, but also make the management unemployed.

7.2.3 Operational Engineering

Expansion in Sub-Saharan Africa primarily in the upper midscale segment. Rezidor has for many years been a large player in the Middle East and Africa region, realizing a successful expansion with its upscale brand Radisson Blu. Rezidor has however showed little interest in establishing its second largest brand, Park Inn by Radisson, which operates in the midscale segment. We believe, for several reasons, that the time is now right to scale up its presence in the mid-scale market: First, the African middle class is growing at fast speed. Second, African economies are growing and becoming more diversified, fuelling intra-African trade activity. Third, as long-distance flights are becoming cheaper thanks to low fuel prices, there is a chance that tourism demand will surge in countries south of Sahara. Fourth, today's tourists to Sub-Saharan countries have few other options but to choose expensive upscale hotels. Fifth, hotel supply is low and there exist substantial barriers of entry. Last, Rezidor is well-established in Sub-Sahara having a sales office in South Africa and a strategic advantage thanks to the partnership with Afrinord.

Expansion of Radisson Red hotels. The global hotel industry is currently experiencing a shift in consumer preferences. By 2020, we can expect that so called Millennial Travelers will account for half of the global hotel demand, putting pressure on hotel operators to meet the demand. To be ready for this shift, Rezidor has recently launched a new brand, Radisson Red for which it plans to open 60 new hotels before 2020. We welcome these expansion plans, as we find it highly important to become an early mover for this customer segment.

Accelerate the rebalancing of Rezidor's business model. During the last couple of years, Rezidor has been phasing out leased properties and instead introduced more franchised and managed hotels. Through the launch of Rezidor's strategic program Route 2015, Rezidor increased the proportions of managed and franchised hotels in their hotel portfolio and was accordingly able to achieve an increased EBITDA margin of 7.7% between 2011 and 2015. As suggested by its peers, a lower share of leased hotels not only improves profitability, but also allows for significant decreases in capex. Under the influence of Blackstone, Hilton undertook a similar rebalance of its hotel portfolio, leading to a reduction of the share of leased hotels from 13.5% to 9.4% over a 6-year period. This decrease yielded significant cuts in capex and helped increasing the cash flow from operations five times over between 2008 and 2012. Thanks to Route 2015, Rezidor has come a long way in the transformation of its business model. However, compared to the peers which are also pursuing similar asset light strategies, Rezidor's share of 20% leased hotels is today still by far the highest. (Appendix G).

Rezidor has still not communicated a plan past Route 2015. Thus, we believe that substantial value can be added by introducing a new program which emphasizes accelerating the rebalancing of Rezidor's business model. Today, Rezidor's pipeline is solely composed of management and franchising contracts, representing 86% and 14% respectively. Under our ownership, we intend to keep prioritizing managed to franchised hotels as well as to stop investing in leased hotels. The reason why we prefer managed over franchised hotels is twofold. First, there are higher EBITDA-margins to achieve with managed hotels than with franchised. Second, as opposed to franchise agreements, management contracts imply that we are in full control of the operation of our hotel portfolio. This means that we are with management contracts in a much better position to guarantee first-class service, which is not the case with franchise agreements. Franchised hotels are operated by third parties, which entails a risk that the operator reduces the quality of its services to save money, but still enjoys the excellent reputation that comes with Rezidor's brands.

Hence, our ambition is keep focusing on an asset light strategy, by maintaining the current hotel pipeline, emphasizing on primarily managed hotels and to a lesser extent franchised. As for our leased hotels, our plan is to stop signing new leasing agreements, but to keep profitable hotels as they are and terminate or renegotiate terms for the unprofitable leased hotels. Specifically, Rezidor should terminate or renegotiate leased hotel contracts in the rest of Western Europe region, while keeping the profitable contracts that are situated in more favorable locations, primarily in the Nordic region.

Improved loyalty program. Customer loyalty has become increasingly important in the last years. We have seen in the case of Hilton that members of the loyalty programs are considerably more profitable customers than non-members. Binding customers closer to the company through loyalty programs is also a way of battling the threat Airbnb and the sharing economy. If customers feel that they are being rewarded for their loyalty, they are less likely to look for cheaper alternatives. As tourism demand in mature hotel markets is growing at a slower pace, much of an individual company's growth is determined by its ability to retain customers and to increase spending per customer.

Rezidor's loyalty program Club Carlson has grown at an impressive rate of 13% per year between 2007 and 2013. Nevertheless, compared to its peers, this is just an average growth rate. In terms of customer satisfaction, Club Carlson is also just an average loyalty program, representing only 15% of Rezidor's occupancy. (Rezidor, 2013b) Hilton on the other hand, as described in section 7.1.3 has accomplished a formidable transformation of Hilton Honors, accounting for 50% of Hilton's occupancy.

By learning from Hilton Honors and implementing some of its key benefits, we believe that Rezidor would be able to grow occupancy similar to that of Hilton. One aspect that makes Hilton Honors attractive is its ease of redeeming points - it for instance entirely lacks blackout dates.[11] (J.D. Power, 2015) In contrast, Club Carlson members are only allowed to choose from eligible dates to redeem their points and member benefits are not available in all of Carlson Rezidor's hotels. Another aspect that could make the Club Carlson more attractive is its network of hotels and partners. As we outlined before, we plan to grow our hotel portfolio significantly in the Africa and Middle East Region, where tourism has grown substantially in recent years and is still for many western citizens an undiscovered destination. By adding exciting locations to the hotel portfolio, we would in addition improve the value proposition of our loyalty program. Similarly, by adding new and exciting partnerships to the program would enhance the customer's propensity to choose our loyalty program rather than the competitor's.

7.3 Expected Holding Period

With regards to the specific investment case in mind, PE funds typically hold their investments for a period of 4 to 8 years. All else being equal, the IRR of an investment will increase if the company is held for a shorter period of time. Historically, a great amount of research has been addressing the holding period of PE investments and how it relates to the return on investment. In a study conducted by Kaplan and Stromberg in 2007, characteristics of LBO transactions were analysed using a sample including 17,171 LBO's, based on data from the Capital IQ database. Kaplan and Stromberg found that the median holding period amounted to 6 years over the full sample while varying slightly over time. (Leveraged Buyouts and PE Steven N. Kaplan and Per Strömberg) The main determinants of how long a PE funds hold their investment depends on several external factors such as the state of exit market and the overall economy. For instance, during the 1990s there is evidence of shorter holding periods on average likely related to the favourable IPO conditions that were present at the time. In contrast, during the global financial crisis of 2008 holding periods were on average longer as an effect limited exit possibilities cause by the problematic economic conditions. (EY, 2013)

Looking at the Nordic context specifically, the Swedish PE firms EQT and Nordic Capital which has been operating in the Nordic region since 1994 and 1989 respectively both have had an

[11] Blackout dates are dates, when booking hotel rooms using rewards is not possible.

average holding period of 4.6 years. (EQT, 2016). Observing LBO's and holding periods in the hotel industry, the Hilton transaction mentioned in section 7.1 was excited by Blackstone after 7 years, potentially prolonged by the financial crisis (Blackstone, 2014). Thus, with regards to the information presented above, the selected holding period has been assumed to be five years as this is deemed standard in our regional context.

8 Section - Forecasting

Having derived a more thorough understanding of Rezidor's historical operational and financial drivers, forward looking projections will be presented next. Typically, when forming financial projections based on assumptions, PE funds formulate scenarios which are the subjects to sensitivity analyses. The scenarios are generally comprised of a base case with conservative assumptions and of an upside scenario on the basis of more optimistic assumptions (Yates & Hinchliffe, 2010). Correspondingly, we will outline our forecast assumptions in a conservative base case and an optimistic upside scenario[12]. Fundamentally, the different assumptions made in each scenario are dependent upon the expected success in the rebalancing of Rezidor's strategy and its impact on profitability.

8.1 Forecast of Revenue

8.1.1 Projection of Future Business Model

As we described in Section 5.3.5, hotel companies generate very different levels of revenues, depending on their business model. To illustrate this, let's take the example of the French hotel company Accor, which is known to be operating most of its hotels under lease contracts. The company reported in 2015 revenues worth EUR 5.58bn. In contrast, the revenues of IHG, with a majority of its hotels under franchise contracts, amounted in the same year to EUR 1.66bn, although its hotel portfolio is almost 50% larger than Accor's. (Statista, 2015) Thus, we can conclude that our anticipated business plan for Rezidor, where we intend to focus on managed and franchised hotels, will have big implications on our future revenue growth. We will therefore start our forecast of revenues by describing our plans for Rezidor's future business model.

As we outlined in the business plan in Section 7.2, we intend to accelerate Rezidor's pursuit of an asset light strategy, through an expansion in primarily managed and secondary franchised.

[12] The upside scenario will be displayed in Appendix I and J.

We will not actively look for opening new hotels under leasing contracts, but we will still keep those who are profitable and renegotiate or terminate those who are not profitable. We will in other words accelerate the path already chosen by Rezidor.

For the purpose of predicting Rezidor's future hotel portfolio, we have considered Rezidor's current pipeline, which amounts to 102 hotels according to the 2015 annual report. For a new hotel to be constructed and ready for use, it takes approximately four years. However, during 2011, 2012 and 2013, 30% of Rezidor's hotel pipeline contained hotels that would be converted from other hotel operators. To get the exact estimates as possible, we are therefore distributing the current pipeline in equal proportions for the next three years, which gives us the following table for the next three years.

Exhibit 40. Estimated Business Model

Forecasted Business Model by Number of Hotels							
Contract Type	**2015**	**Pipeline**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Franchised	95	14	100	104	109	120	135
Growth	8%	-	5%	5%	4%	10%	13%
Managed	189	88	222	253	283	320	355
Growth	4%	-	18%	14%	12%	13%	11%
Leased	71	0	71	71	71	71	71
Growth	1%	-	0%	0%	0%	0%	0%
Total	355	102	393	428	463	511	561

Source: Rezidor (2015a), Own creation

As can be seen in exhibit 40, we have also included estimates for 2019 and 2020. In line with our strategy described in the business plan of section 7.2, our ambition is to accelerate the rebalancing of Rezidor's strategy, by intensifying growth in managed hotels.

8.1.2 Nordics

Rezidor's home market, the Nordics, has been its greatest problem child in the last three years, where Rezidor's RevPAR has dropped by 6.7%, partly influenced by unfavourable exchange rates. Rezidor is the market leader in the upper upscale segment, a segment that relies heavily on the overall business confidence which in turn is driven by the health of the economy. Nordic economic activity has been growing slowly in the past years, with large national differences. For instance, is Sweden on the one hand growing above 3% per year and on the other hand is Finland a country that has been experiencing stagnation since 2012. IMF expects however accelerated growth rates in all Nordic countries in 2016 and stable annual growth above 2%

until 2020. UNWTO predicts at the same time tourism to grow 2.2% annually. (Tourism Highlights 2015)

As displayed in exhibit 13, the Nordic region is only represented by 2% of the current pipeline of new hotels, meaning that we will have about the same number of hotels in the next years. Under our ownership, we intend to keep the current hotel portfolio as it stands and decide to expand in other markets with higher growth potential. We can therefore calculate our sales growth on the current hotel portfolio and pipeline and we expect that our hotels will reverse the negative trend in RevPAR, thanks to a healthier regional business climate, a growing number of tourists and a moderate industry supply in new hotels. Having reached rock bottom RevPAR rates in 2015, we believe that Rezidor in an upside scenario would be able to achieve a strong growth in 2016 and 2017 of 3.0% per annum and reasonable growth rates of 2.5% for the rest of the estimation period. In our base case, we are expecting economic activity to remain at rather low levels in the Nordics, influenced by continuous stagnation in Finland and low growth in Norway. Dampening RevPAR growth in the upper upscale segment, we expect revenues in such a conservative forecast to grow by 2.5% per year in 2016 and 2017. Since we do not intend to open more hotels in this region, it is reasonable to expect revenue growth rates to be lower in the long run, hence we calculate with a 2% growth in 2018 and 1.5% annual growth in 2019 and 2020.

8.1.3 Rest of Western Europe

The Rest of Western Europe, which is the Eurozone, excluding Finland but including the UK and Switzerland, will according to IMF's forecasts grow annually between 1.7% and 1.8% until 2020. Tourism is expected to grow hand in hand with the economic activity, UNWTO predicts an annual growth rate of 2.3% in the next 5 years. Supply of new hotels has for several years lagged behind demand and this imbalance will according to PWC persist, even though pipelines are picking up in 2016. Comparing the pipeline of hotels in January 2015 to January 2016, there is a 15.8% increase in hotels and 6.3% increase in rooms. (PWC, 2016)

Solid demand growth and a moderate increase in supply will therefore imply a positive development for RevPAR in the near future. Considering that we will phase out a few leased hotels located in the Rest of Western Europe Region, we are counting with a lower growth in revenues, than if we would keep the hotel count constant. We believe therefore that Rezidor in an upside scenario would be able to grow its sales by 2.0% per annum. As for the base case, we estimate an annual sales growth of 1.0%.

8.1.4 Eastern Europe

Development in Eastern Europe is particularly vulnerable for Rezidor, due to the aggressive expansion that the company has undertaken in the past 5 years. The region has in the past showed to have a fairly volatile development, both as measured in GDP growth as well as measured in the number of tourist arrivals. Regarding the economic activity in Eastern Europe, the IMF expects the stagnating year of 2015 to be an exemption, and predicts annual growth rates to be 2.4% on average until 2020. UNWTO expects the number of tourists to grow by an annual average of 3.7%.

Although being a very heterogeneous region, the hotel industry of Eastern Europe is highly dependent on political stability in order to reach its full growth potential. As described in section 5.1.3, the hotel industry in many Eastern European countries has in the past years been negatively affected by the events following the situation in Ukraine. Rezidor, being the largest operator of upper upscale hotels in Eastern Europe, with a particularly strong presence in Russia is of course highly dependent on the situation to stabilize. We are therefore in our upside scenario expecting improved relationships between Russia and the EU by 2017, which will have a significant impact on the region's growth, both in terms of economic activity and tourism. As a result, we can expect high growth in both business and leisure travel. Thus, we believe that Rezidor's revenues in 2016 will grow in line with the GDP and tourism, which is 3%. As for 2017 and 2018 we calculate with growth rates of 4%, whereas revenues in 2019 and 2020 will grow at 5% due to increased business activity. In contrast we predict in the base case scenario that the political situation will remain tense, which will have the biggest effect on Russia, where Rezidor has most hotels in the region. We therefore forecast a base case of a cautious 2% per annum until 2020.

8.1.5 Middle East and Africa

Middle East and Africa is another region, in which Rezidor in the last years has been very active. The region will become increasingly important, since 60% of Rezidor's pipeline of new hotel openings will take place there. GDP growth in the region has in the past years been high, showing a CAGR of 3.7%. IMF anticipates the high growth to continue until 2020, averaging 4.3% per year. The development of tourism has on the other hand been quite volatile, mainly due to the political instability following the Arab spring, which has had serious effects on tourist demand in countries such as Egypt, Libya and Tunisia. Looking forward, the UNWTO predicts annual growth rates in the region to be 5.3% until 2020.

Similar to Eastern Europe, development of this region is to a high extent reliant on political stability. Rezidor has in the past years been fortunate on having only a few hotels in Northern Africa, where most of the political unrest has taken place. Instead, the large part of the MEA hotel portfolio is situated in either the Middle East or in the countries south of Sahara. Growth is in many of these economies correlating with commodity prices, of which oil is the most important. However, economic development has been positive in the last two years, despite declining commodity prices, which is due to the fact that these economies have become more diversified. We believe that Rezidor is thanks to its excellent network in the region very well prepared to expand to meet the high hotel demand. In an upside scenario, we expect conflicts to be absent as well as growing economies due to higher commodity prices and greater diversification. Rezidor will be successful at opening many new hotels on short notice, taking advantage of the increase in demand. Our expectations in such a scenario are growing revenues of 5% in 2016 and 2017, while revenues grow at a slightly lower pace at 4% due to increased competition. In our base case scenario, we adjust for continued political unrest in North Africa, but also in other countries such as Syria, Nigeria, South Sudan and Western Sahara. We believe that conflicts and declining commodity prices will deter tourists and business travellers from visiting parts of the region, but that other parts of the region continue to grow. In such a scenario, we believe that adequate annual growth rates are 2.5% per year until 2020.

In exhibit 41, a summary of the base case revenue projections is provided.[13]

Exhibit 41. Forecast of Revenues

Revenue Forecast by Region			**Forecast Period**		
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Nordics	452	464	473	480	487
Growth	*2.5%*	*2.5%*	*2.0%*	*1.5%*	*1.5%*
Rest of Western Europe	494	499	504	509	514
Growth	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*
Eastern Europe	36	36	37	38	39
Growth	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
Middle East, Africa & Others	33	33	34	35	36
Growth	2.5%	2.5%	2.5%	2.5%	2.5%
Total Revenue	**1,014**	**1,032**	**1,048**	**1,062**	**1,076**
Total Revenue Growth	*1.7%*	*1.8%*	*1.5%*	*1.3%*	*1.3%*

Source: Rezidor (2015a), Own creation

[13] The upside forecast scenario can be found in Appendix I.

8.2 Forecast of Costs

Having established the projections of revenues, a breakdown of the cost forecast will follow. As addressed in section 6.3.1, Rezidor's cost development is highly dependent on the development of its hotel portfolio and the share of leased, managed and franchised contracts it comprises. For that reason, our earlier estimated development of Rezidor's business model, illustrated in exhibit 8.1.1, will form a key part of the cost forecast. Essentially, the cost items associated with each contract can be categorised as fixed costs[14], variable costs[15] or if cost items are bundled, it can also be a mixture of the two. Fixed costs are almost exclusively generated by leased hotel contracts whereas both leased hotels as well as managed and franchised hotel can incur variable costs. As we intend to keep the number of leased hotels unchanged in the coming five years, we will therefore assume fixed costs to remain constant in our base scenario, and assume a small decline for costs in the upside scenario. As for variable costs, the forecast becomes more cumbersome, as they depend on our forecasts of sales, but also on cost-saving measures. To make it as comprehensible as possible, we will walk through each cost item, state whether it is a fixed or variable cost and last present our projections. As can be seen in Rezidor's reported income statement (Appendix B), the cost items affecting EBITDA and EBIT are the following:

Costs of goods sold for Food & Drinks and other related expenses: This item represents costs related to operations of leased hotels, of which costs for food account for ca. 63% of the reported consolidated item (Rezidor, 2015a). Moreover, based on a common-size and indexing analysis of Rezidor's income statement it is evident that the cost item displays a decreasing pattern both as percentage of sales and when being indexed to a base value.

Thus, as the growth in managed and franchised hotel contracts has no effect on the item, we will base our forecast of this item solely on our estimated development of leased hotels and therefore assume the item to remain unchanged as a percentage of sales. Thus, we consider it fair to assume that the item maintains present levels in our base case scenario while decreasing slightly over time as a percentage of sales in our upside scenario.

Personnel cost and contract labour: This item relates to typical employee expenses such as salaries, wages, social security costs and pension contributions. As we outlined in section 4.3.1, Rezidor is under leased hotel contracts responsible for the supply of staffing but does not have such obligations under managed or franchised hotel contracts. In the 2015 annual report, Rezidor reveals that about 4% of the total "personnel cost and contract labour" reported were

[14] Costs that are unrelated to sales.
[15] Costs that vary depending on sales.

attributed to senior officers within the group. Hence, we infer that the lion's share, approximately 96% of the cost item is related to the operation of leased hotels. From the common-size analysis we observe a constant development of the item as measured as a percentage of sales while we can see a slightly increasing trend based on the indexing analysis. However, as we will not increase the number of leased hotels, we consider it being a fair assumption that personnel cost and contract labour will remain constant.

Other operating expenses: This item includes expenses such as "royalty fees to Carlson Group", "energy and supply costs", "marketing expenses", "administrative costs", "laundry & dry cleaning", "operating equipment" and "property operating expenses". Since the item contains a bulk of expenses, which in addition are very different from one another, it makes it difficult for us to make an exact assessment of how the items relate to Rezidor's different contracts types. For instance, marketing expenses are expenses incurred by all contract types.

However, based on Rezidor's (2015a) breakdown of the specific sub items that form other operating expenses, we have estimated that 20% stem from Rezidor's leased hotels. These sub items include predominantly "energy costs" and "laundry & dry cleaning", and will according to Rezidor (2015a) be subject to measures for additional cost saving. Moreover, as a result of cost initiatives associated with Rezidor's Route 2015 program, rent reductions were realised which implies that there could be further cost reductions achieved in this cost item. Looking at the historical level as a percentage of sales, we can identify a highly consistent pattern. Thus, we consider it fair to assume that other operating expenses will continue to follow the historical pattern, constituting 24% of sales, in our base case whilst being slightly decreasing in our upside scenario.

Insurance of properties and property tax: Similar to the costs of goods sold for food & drinks, this item relates entirely to Rezidor's leased hotels. We will therefore consider this item to remain constant in our base case, while we forecast a minor decrease in our upside case.

Rental expense: Primarily, this item relates from Rezidor's leased hotels where it constitutes a substantial part of the operating costs of the hotels. However, the item also includes management guarantee payments to hotel owners, which is an expense associated with Rezidor's managed hotels. Due to the insignificant size of these management guarantee payments, making up for 0.7% of the total rental expenses in 2015, we regard it being too small for having a materialising impact on our projection of rental expenses. Judging by the historical development, we can see that rental expenses have barely changed in years between 2011 and

2015. Therefore, we assume that we in our base case are able to maintain constant levels of rental expenses, whereas we estimate a marginal decline in our upside scenario.

Depreciation and amortisation (D&A): D&A relates to all contract types and is therefore a mixture of both fixed and variable costs. A breakdown in the 2015 annual report indicates that amortisations account for 11%, while depreciations stand for the remaining 89% of this item. (Rezidor, 2015a) Amortisations relate to the intangible assets and licenses & related rights associated with the master franchise agreement with Carlson Group. Depreciations are on the other hand driven by the depreciation of Rezidor's tangible assets, such as fixed installations and machinery & equipment. Observing Rezidor's historical level of depreciation and amortisation in relation to sales, we see a rather unchanged development and we find no reason to assume otherwise in our forecast. Future depreciation is also to a high extent driven by the current level of capex, in other words, investments that are made today will be depreciated in the years to come. Since it is part of our business plan to keep capex at low levels, we believe that this will contribute to maintaining the unchanged development of D&A. Consequently, we will assume depreciation and amortisation expense at the historical average level of 3.5% in relation to sales for both our forecast scenarios.

Write-downs and reversal of write-downs: This cost item refers to impairment testing which is carried out by Rezidor on a yearly basis. During such a testing, Rezidor's tangible assets, intangible assets and hotel contracts are assessed in order to detect potential impairments. This is conducted through a discounted cash flow (DCF) analysis where each of Rezidor's hotel contracts is evaluated independently based on factors such as the remaining contractual and financial terms. If the net present value from the DCF is lower than the net carrying value on the balance sheet, Rezidor will report a write-down. Most of the write-downs have historically been associated with Rezidor's leased hotels and due to the declining trend of the leased share of the hotel portfolio, write downs have remained at rather low levels as well. Thus, given the estimated future business model and the declining share of leased hotels, it is fair to assume that costs related to write-downs will decrease going forward. More specifically, with reference to the historical pattern where write-downs as a percentage of sales have decreased consistently, we will anticipate a similar development in our forecast. From the base level of 0.6% of sales in 2015 we forecast an annual decrease of 0.2%, levelling off to zero in the year of 2019 for both forecast scenarios. (Rezidor, 2015a)

Costs due to termination/restructuring of contracts: As this item is part of our strategy of rebalancing Rezidor's business model, we are expecting to increase the level of this expense going forward. Given that the historical level as percentage of sales has been rather volatile, being 1% of sales in 2012 at the launch of Route 2015 while accounting for 0.1% of sales in 2015, we will use the average level of 0.3% between 2011 and 2015 as a starting point for our forecast. Thereafter, we calculate with an annual increase averaging 0.05% in both forecast scenarios. (Rezidor, 2015a)

Loss on sale of shares and tangible fixed assets: Given the inconsistent pattern and low historical level of this item, we will assume it to be zero in both our forecast scenarios.

In exhibit 42 we display a summary of the base case forecast scenario.[16] The table shows us all projections of revenues and costs, in turn generating EBITDA and EBIT. In the following section, these estimates of EBITDA and EBIT will come handy as we are going to use them for computing net debt at the time of exit.

Exhibit 42. Forecast of EBITDA and EBIT

Forecasted EBITDA and EBIT	Forecast Period				
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Revenue	**1,014**	**1,032**	**1,048**	**1,062**	**1,076**
Growth	*1.7%*	*1.8%*	*1.5%*	*1.3%*	*1.3%*
Costs of Goods Sold for Food & Drinks and Other	-58	-58	-58	-58	-58
Personnel Cost and Contract Labour	-349	-354	-358	-362	-366
Other Operating Expenses	-244	-248	-252	-255	-258
Insurance of Properties and Property Tax	-16	-16	-16	-16	-16
Rental Expense	-243	-243	-243	-243	-243
Share of Income in Associates and JV's	2	2	2	2	2
EBITDA	**107**	**116**	**123**	**130**	**137**
Margin	*10.6%*	*11.2%*	*11.8%*	*12.3%*	*12.8%*
Depreciation and Amortisation	-35	-36	-36	-37	-37
Write-Downs and Reversal of Write-Downs	-6	-4	-2	0	0
Costs due to Termination/Restructuring of Contracts	-3	-3	-4	-4	-5
EBIT	**63**	**72**	**81**	**89**	**95**
Margin	*6.2%*	*7.0%*	*7.7%*	*8.4%*	*8.8%*

Source: Own creation

8.3 Forecast of the Balance Sheet

As we have now completed the forecast of the income statement, we will devote the remaining part of Section 8 to project the balance sheet. Changes in the balance sheet will reflect the adjustments in the capital structure imposed by the change in ownership. These changes will enable us to estimate Rezidor's net debt at the time of our exit, which we have set in year 2020. The level of net debt in 2020 will be a key element in deriving the IRR of the LBO, performed in section 9.5. Exhibit 43 illustrates the base case forecast of the balance sheet. However, as the

[16] The upside forecast scenario can be found in Appendix I.

forecast of the balance sheet is heavily influenced by the level of free cash flows as well as the the debt composition and the pricing terms. A full estimation procedure will be addressed more in detail in section 9.2 to 9.4.

It is important to highlight that our plans for rebalancing Rezidor's future business model will not impact Rezidor's balance sheet more than the marginal effects associated with reductions in capex. The reason behind this is that Rezidor's classifies its leased hotels as operating leases, which in contrast to financial leases do not appear on the balance sheet. (Rezidor, 2015) Instead, lease payments are recognised in the income statement in the form of rent and operating expenses (ibid, 2015).

Exhibit 43 shows that the individual items that have the largest impact on our balance sheet forecast for Rezidor are "Acquisition Goodwill", "Equity" and the "Interest Bearing Debt". These forecasted items, as well as the smaller items will be explained in further detail.

Goodwill will become a large item, as it will display the premium value that we pay for Rezidor in excess of the book value of equity that is recognised on Rezidor's balance sheet prior to the acquisition. The acquisition goodwill is projected to remain constant during the holding period. Further, non-current operating assets will be impacted by the difference between projected accumulated capex and depreciation during our holding period.

As we mentioned in section 7.2.3, we expect capex to decrease in future, as a result of the rebalancing of Rezidor's business model and our strategy to maximise free cash flows for debt service. We believe that for our base case scenario, a feasible annual cut in capex as a share of sales would be 0.5% per year. At this rate, capex as a share of sales would decrease from 4.8% in 2015 to 3.5% of sales in 2019 and 2020. As for our upside scenario, we are counting with a more aggressive reduction, lowering capex to 3.5% of sales already in 2016 and maintaining the same levels in the following years. In the earlier forecast of costs, we projected in both our scenarios that depreciation would keep the same percentage of sales in the following five years, namely 3.5%. Subtracting depreciation from capex will therefore in our base scenario yield a minor net increase in the item named "Accumulated Capex Net of Accumulated Depreciation." The same item will however remain constant, since we are calculating with the same levels of capex as a share of sales as with depreciation. Beyond the generation of the acquisition goodwill and the effect of accumulated capex net of accumulated depreciation, we expect remaining non-current assets to stay unchanged over the estimation period.

Hence, our base case projects that the net effect of non-current operating assets will be a small increase until 2018, keeping the same level in the two years that follow. In contrast, our upside scenario assumes an annual capex to equal with annual depreciation yielding an unchanged non-current operating asset base throughout the holding period.

As for operating working capital, we earlier identified in section 6.3.3 the item to be stable and negative around -5.3% of sales in the last five years. We could also see that negative working capital ratios were not uncommon in the industry and that the peer companies managed to reduce their working capital even more, thanks to significant cuts in their inventory values. From this, we drew the conclusion that Rezidor should have some room to reduce their current operating working capital. However, according to Damodaran (2005) it is uncommon to assume increasing levels of negative operating working capital in the context of valuations. We therefore assume an unchanged operating working capital to sales ratio of -5.3% for the years going forward for both forecast scenarios.

Considering Rezidor's net debt, which we discussed in section 6.1.2, we intend to convert Rezidor's financial assets into cash at the time of the acquisition. Such a conversion entails the assumption that "assets held for sale" are recognised at a fair value in Rezidor's financial reporting. However, as Rezidor states in the 2015 annual report that asset held for sale "are recognised at fair value less the costs to sell". (Rezidor, 2015a) Our plan is to use the cash proceeds from the asset held for sale to repay Rezidor's current interest bearing liabilities, leaving us with a surplus of net cash amounting to EUR 56.4m. The cash balance on Rezidor's balance sheet will thus correspond to the minimum cash level, which will be further described in section 9.2.3. The forthcoming projected cash balance is dependent on the free cash flows and debt repayment schedule, which we will address in section 9.3 and 9.4.

The debt raised on order to finance the acquisition will replace the short and long-term interest-bearing debt. The closing balance of debt in 2016 will thereby equal the total debt used in the funding of the acquisition, less the repayments made over the year. In the years that follow, the debt is projected to decrease over the holding period as we will amortize each year. Further, the opening balance of shareholder equity in 2016 equals our equity contribution in order to fund the transaction in addition to the retained earnings of the year, which we will address in section 9.2.3. In the absence of dividends, the equity is projected to increase over the holding period as the forecasted net income will appear on the balance sheet in the form of retained earnings. In this way, we will increase our ownership share of Rezidor by exclusively using free cash flows to pay off the debt.

Remaining items on Rezidor's balance sheet are expected to stay unchanged during our ownership of Rezidor. Correspondingly, we will not display each item as the closing balance of each item in 2015 can serve as a proxy for the future level in the holding period. Key selected items on Rezidor's projected balance sheet is displayed below, exhibit 43.

Exhibit 43. Forecast of the Balance Sheet

Pro Forma Analytical Balance Sheet			Forecast Period		
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
OPERATIONS					
Acquisition Goodwilll	*575*	*575*	*575*	*575*	*575*
Accumulated Capex Net of Accumulated Depreciation	*13*	*21*	*24*	*24*	*24*
Existing Non-current Asset Opening Balance	*271*	*271*	*271*	*271*	*271*
Non-Current Operating Assets	859	867	870	870	870
Current Operating Assets	128	130	130	131	132
Non-Current Operating Liabilities	27	27	27	27	27
Current Operating Liabilities	182	184	186	187	189
Operating Working Capital	-54	-55	-55	-56	-57
Invested Capital (Net Operating Assets)	778	785	787	786	786
FINANCIALS					
Equity	304	336	376	424	478
Interest Bearing Debt	494	469	432	384	330
Interest Bearing Assets / Cash	20	21	21	21	22
Net-Interest Bearing Debt (Financial Liabilities)	474	448	411	363	308
Invested Capital (Net Financial Assets)	778	785	787	786	786

Source: Own creation

9 Section – Leveraged Buyout Valuation

Having forecasted the income statement and balance sheet, we now turn to the deal structure and perform the LBO valuation. In this section, we will first determine the acquisition price. Second, we will structure the deal and describe the sources of funds. Third, we will estimate the free cash flows and debt schedules in order to project the net debt at the time of exit. Fourth, we will discuss the return we get from the base case scenario and the upside scenario, as well the impact certain deviations could have on our calculations. Fifth and last, we will discuss the exit possibilities of this leverage buyout process.

9.1 Acquisition Price

As we explained in section 3.2, the entry price constitutes an important part of the leveraged buyout transaction as it has a direct impact on the potential IRR that the investment can yield.

As for the assumed date of acquisition, set as April 21st 2016, Rezidor's share price amounted to SEK 34.2. The number of diluted outstanding shares[17] was reported to be 172.9 million. (Rezidor, 2015a) By multiplying the number of shares outstanding with the share price we get Rezidor's market capitalization, which amounted to SEK 5,913m. Converted to Euros, this equals a total market capitalization of EUR 632m.

The next step is to assume an appropriate acquisition premium. Further, acquirers often pay a premium for purchasing the majority of the control rights of a company, a premium called control premium. (Damodaran, 2007). According to Kaplan & Strömberg (2008), the scale of the premium is influenced by several regional and industry specific factors and varies over time. In a typical LBO transaction, a premium between 15% and 50% above the company's current stock price is usually paid (Kaplan & Strömberg, 2008). Bargeron et al. (2007) finds that PE firms on average offered an acquisition premium of 28.5% to target shareholders in public companies between the years of 1980 and 2005. In Eckbo's study from 2010, the average purchase premium in 1,058 LBOs between 1973 and 2006 amounted to 32%.

From this we can conclude that a typical PE transaction requires a premium of 30%. Going forward, we will assume to offer a premium of equal size in the LBO of Rezidor. This means that the equity purchase price of Rezidor will amount to EUR 821m. Adjusting for Rezidor's net debt, we arrive at an enterprise value of EUR 765m. Correspondingly, given Rezidor's EBITDA of EUR 101.1m in 2015, we will be paying an enterprise value multiple of EBITDA of 7.6x.

9.2 Deal Structure

In this section, we will address the financing considerations of the leveraged buyout by determining the total amount of leverage needed, as well as the debt structure.

9.2.1 Leverage

In order to determine the total amount of debt that we can borrow for the LBO of Rezidor, we will use the debt multiple of EBITDA, which is a measure commonly applied in the finance industry (Rosenbaum & Pearl, 2009, p.37). EBITDA is considered to display a relatively fair representation of operating cash flows and is therefore a good proxy of the company's ability to service debt payments (Petersen & Plenborg, 2012, p.58). The total amount of the debt that creditors are willing to lend in LBOs depends on a number of factors, company specific factors, such as the quality of the target company and the company's track record, case specific factors,

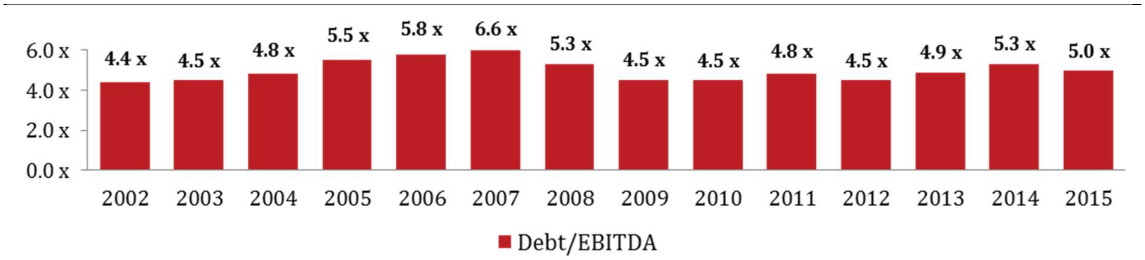
[17] This excludes shares held as treasury and includes shares outstanding in executive long-term equity settled incentive programmes.

such as the amount of equity contributed by the PE fund as well as the current economic environment and the prevailing willingness among banks to take risk. (Rosenbaum & Pearl, 2009, p.160-161)

Moreover, the target company's risk-profile may also impact the amount of leverage that creditors are willing to lend. Historically, it has not been uncommon that companies with highly and stable cash flows have been acquired with debt comprising 90% of the acquisition price. However, in a traditional LBO debt levels as a percentage of the purchase price typically comprise between 60% to 70% (Rosenbaum & Pearl, 2009, p.161). Hence, the amount of debt as well as the size of the debt multiple varies quite much and determining a feasible level is therefore subject to a degree of uncertainty. Given that the selected level of debt also impacts the IRR of the acquisition, it is common among industry practitioners to conduct sensitivity analyses for various debt levels to examine its impact on the return. We will carry out such a sensitivity analysis in section 10.

For the purpose of determining an appropriate debt multiple for our LBO of Rezidor, we have collected the average debt multiples of European LBOs between 2002 and 2015[18], illustrated in exhibit 44. In this graph, we can see that debt multiples have varied between 4.4x and 6.6x. Moreover, we can conclude that the years of low multiples have coincided with years of economic recessions, as in 2002 and 2009. Since 2010, European debt multiples seem to have recovered, except from a dip in 2012.

Exhibit 44. Debt/EBITDA Multiples in European LBO's



Source: Capital IQ (2016), Own creation

Given that we assume the role of a typical Nordic PE fund and have carried out a thorough selection process in which we picked the most suitable LBO candidate, we consider it fair to assume that a debt multiple equal to the European average in 2015 can be applied in our case.

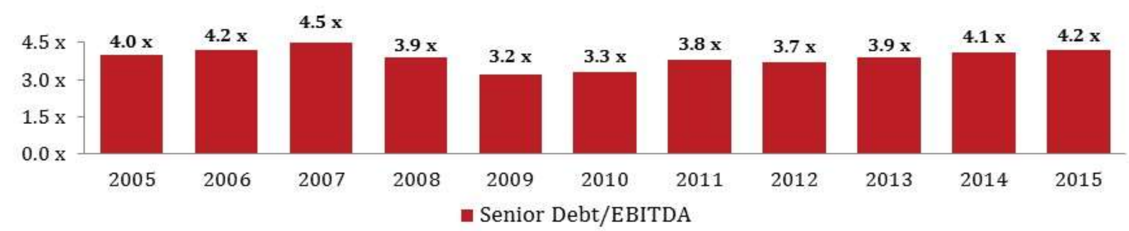
[18] We have excluded LBOs with an EBITDA below USD 50m.

We will therefore choose a debt multiple of EBITDA of 5.0x and by applying Rezidor's reported full year EBITDA from 2015 we arrive at a total debt level of EUR 506m.

9.2.2 Debt Structure

A core expertise among PE funds is their ability to access cheap financing through their excellent relationships with investments banks. (Stowell, 2010, p.283) Banks are also typically interested in providing debt in LBO transactions as such transaction yield higher interest rates compared to the regular corporate lending. Historically, debt structures utilised in LBO transactions have varied quite substantially. However, it is rather unusual that bank debt form the minority of the debt structure (Rosenbaum & Pearl, 2009, p.179). Exhibit 45 displays the senior debt multiples of EBITDA for European LBO's between 2005 and 2015.

Exhibit 45. Senior Debt/EBITDA Multiples in European LBO's



Source: Capital IQ (2016), Own creation

From exhibit 45, we can infer that the Senior Debt multiples follow the same pattern as the average debt multiples of exhibit 44. In years of low debt multiples, as in 2009, the receptiveness of the loan market declined significantly and instead many PE firms turned to the high yield bond market to access funding. More recently, resulting from the increased stability in European stock markets and the low interest rate environment, we can observe an increasing trend in the multiple of senior debt to EBITDA. The senior debt of EBITDA multiple shows a consistent surge since 2011 and in 2015, it equalled a ratio of 4.2x.

In line with a typical debt structure of a LBO transaction, as described in section 3.5, and the favourable lending environment for receiving senior debt, we will in our LBO case assume the following debt structure: 54% of the total capitalisation and 84% of the total debt will be comprised of senior secured debt corresponding to a 4.2x multiple of EBITDA in 2015. The remaining 10% of the capitalisation and 16% of the total debt are assumed to be composed of subordinated debt. This is because we consider senior debt to be superior to other debt alternatives, such as high-yield bonds, due to size and public disclosure requirements associated with such instruments (Rosenbaum & Pearl, 2009, p.184). The debt will be formed by a syndicate of reputable investment banks in order to increase the benefits of diversification. We consider utilising such debt syndicate a realistic assumption with regards to our case and outlined assumptions.

Next, we will structure the senior debt into two tranches, amortisation term loan A (TLA) and institutional term loan B (TLB) and both will be collateralised against Rezidor's receivables, inventory, and property, plant and equipment in order to get the lowest interest rates. TLAs are considered to be less flexible than TLBs due to stricter amortisation schedules and larger shares of mandatory repayments during its maturity. For this reason, TLBs typically constitute a larger share of the debt structure in LBOs. Accordingly, we will assume a relationship where the TLB constitutes 70% of the senior debt and where the TLA accounts for the remaining 30%.

The TLA will have an assumed maturity of 5 years, which is in accordance with the length of the holding period, and will include a predefined amortisation schedule with annual principal repayments during its lifetime. The amortisation schedule could be outlined in other ways, but referring to the typical TLA amortisation schedule as displayed in Rosenbaum & Pearl (2009), we assume the following structure: 5% of the TLA will be amortised in 2016, 10% in 2017, 20% in 2018, 30% in 2019 and the outstanding 35% in 2020. (Rosenbaum & Pearl, 2009, p.183) With reference to the applicable interest rate assumptions, as addressed in section 3.5, TLAs are usually priced based on a floating interest rate, made up by a base rate plus a spread depending on the borrower's credit ratings. According to Vernimmen et al. (2014, p.844) the average spread on senior debt used in LBO's between 2008 and 2014 has been between 400 to 600 basis points (bps).

Considering recent transactions within the Nordic region and the hotel industry, we believe this to be a fair approximation of the pricing terms and we deem the terms to be applicable for our case. Taking the example of Scandic Hotels, which until October 2015 was the target of a LBO executed by the Swedish PE firm EQT, we could find that the term loans in SEK[19] were priced based on STIBOR[20], in addition to a spread ranging from 200 to 400 bps per annum (Scandic, 2015b). Scandic's net debt multiple of EBTDA in 2014 amounted to approximately 6.0x, making the case fairly comparable considering our assumed leverage of 5.0x in our LBO of Rezidor. (Scandic, 2015a) Consequently, we will assume an equal base rate for our TLA and TLB loans. As for the additional spread, we will first estimate Rezidor's credit rating using Moody's credit

[19] Term Loans were renegotiated in 2014 (Scandic 2015b).
[20] Stockholm Interbank Offered Rate.

rating model for the hotel industry. Having derived the appropriate credit rating, we will assume a spread that firms with the same rating usually get.

In general, when rating agencies such as S&P and Moody's assign credit ratings on senior debt, most of their ratings vary between BB+ to B+ (Damadoran, 2004). As for the hotel industry in particular, Moody's are considering business models with high proportions of owned and leased hotels to be more risky. This is because owned and leased hotels require a more capital intensive and have lower margins than franchised and managed hotels. (Moody's, 2015). Moody's rating methodology for hotel companies considers aspects such as a company's competitive position, diversification, profitability, cash flows and financial policy. By benchmarking Rezidor against the given criteria, which are illustrated in exhibit 46, we arrive at an estimated credit rating of Baa. In general, firms such credit of creditworthiness is usually granted a spread of 433 bps on such a five-year maturity loan, exhibit 47, which are terms that we believe are acceptable (Koller et al., 2010, p.259). Hence, as a result from the assessment of Rezidor's creditworthiness, the terms of the TLA loan will have an assumed interest rate of the floored STIBOR plus a spread of 433 bps.

Exhibit 46. Estimation of Rezidor's Credit Rating

	Rezidor's Score	Aaa	Aa	A	Baa	Ba	B
Factor 1 – Market Position	0.5%	> 20%	10% – 15%	5% - 10%	0.5%	0.5%	0.5%
Global Market Shares	2.7%	> 15%	10% – 15%	5% - 10%	ca. 5%	ca. 3%	ca. 1%
CAGR of Rooms (2011–2015)	5.0%	> 40%	35% - 40%	30% - 40%	20 – 30%	10% – 20%	5% - 10%
Factor 2 - Diversification							
# Segments	3	5	5	4	3	3	1
% of EBITDA from Top 10 Properties	< 15%	15%	20%	20% - 30%	30% - 50%	50% – 80%	> 80%
% of EBITDA from Top Region	33%	> 10%	> 10%	ca. 10%	10% - 30%	30% - 60%	> 60%
Factor 3 - Profitability							
EBITA Margin	6%	> 25%	20% - 30%	15% - 25%	10% - 20%	5% - 10%	< 5%
EBITA/Average Assets	14%	> 18%	13% - 18%	8% - 13%	5% - 10%	2% - 5%	< 2%
Factor 3 – Cash Flow & Financial Policy							
Retained Free Cash Flow / Total Debt	13%	> 60%	40% - 60%	30% - 40%	15% - 30%	10% - 20%	< 10%
Total Debt / EBITDAR	1.5x	< 1x	1x – 1.5x	1.5x – 2.5x	2.5x – 4x	4x – 6x	< 6x
Total Coverage	6.2x	> 8x	6x – 8x	4x – 6x	2x – 4x	1x - 2x	< 1x
EBIT/ Interest Expense	8.9x	> 10x	> 10x	10x – 7x	7x – 4x	4x – 2x	2x – 1x
Factor 2 –Liquidity							
FCF/ Total Debt	4.4%	> 25%	20% - 25%	15% - 20%	5% - 15%	0% - 5%	< 0%

Source: Moody's (2004), Own creation

Exhibit 47. Yield spreads and Credit Ratings

Yield Spread over U.S. Treasuries by Bond Rating (Basis points)							
Rating	Maturity						
	1	2	3	5	7	10	30
Aaa/AAA	36	59	55	69	82	58	139
Aa2/AA	154	140	150	160	168	139	179
A2/A	159	153	166	169	168	139	182
A3/A-	183	178	192	193	189	152	190
Baa1/BBB+	324	310	336	333	324	288	320
Baa2/BBB	332	315	340	338	328	292	324
Baa3/BBB-	402	408	425	433	421	380	416
Ba2/BB	559	583	586	590	578	545	577
B2/B	870	916	913	925	909	878	904

Source: Koller, Goedhart, and Wessels (2010), Own creation

TLB will be subordinated TLA in terms of seniority and will therefore be structured as a bullet loan with a longer maturity of 8 years and mandatory principal repayments of 1% per annum (Rosenbaum & Pearl, 2009, p.183-184). Thereafter, the outstanding amount of the TLB will be repaid as a bullet payment at the end of maturity or at the time of exit. As amortization term loans are perceived to be less risky than bullet term loans, we will apply a slightly higher interest rate will be on the TLB compared to TLA. This aspect is reflected by the imposition of a higher spread, assumed as 600 bps, whereas the base rate STIBOR will be the same.

Concerning the subordinated debt, which accounts for the remaining 16% of the debt capital structure, it will have an assumed maturity of 10 years and will be structured as a bullet term loan with no mandatory repayments during its lifetime. The interest rate will be assumed as 10% as this can be considered typical for debt compositions of such kind in LBOs (Damadoran, 2004). An overview of all interest rate assumptions is displayed below, exhibit 48.

Exhibit 48. Interest Rates Summary

Interest Rates Assumptions						
	Pricing	2016E	2017E	2018E	2019E	2020E
Forward STIBOR Curve		-0,154%	-0,158%	-0,129%	-0,010%	0,010%
Forward STIBOR Curve (Zero Floor)		0,000%	0,000%	0,000%	0,000%	0,010%
TLA	S + 433 bps	4,333%	4,333%	4,333%	4,333%	4,343%
TLB	S + 600 bps	6,000%	6,000%	6,000%	6,000%	6,010%
Subordinated Debt	1,000 bps	10,00%	10,00%	10,00%	10,00%	10,00%

Source: Bloomberg (2016), Own creation

9.2.3 Sources and Uses of Funds

Having derived the amount and structure of the debt, the uses of funds will be established in order to determine our required equity contribution in funding the LBO. In the context of LBOs, practitioners commonly use a sources and uses table to summarise the deal structure. Sources provides information about where the capital used in the acquisition stems from while uses of funds display how such capital will be utilised in the transaction. (Rosenbaum & Pearl, 2012, p. 208)

Usually, the uses of funds correspond to the acquisition price subjected to the control premium, a refinancing of the net debt and a minimal cash balance contribution (Rosenbaum & Pearl, 2012, p. 270). As Rezidor is net cash positive at the time of the acquisition, in other words having a negative net debt, there is no debt to refinance. Instead, most of the existing net positive cash balance will help to reduce the acquisition price paid in the LBO. A small cash balance is however needed for maintaining operations during the LBO process and such cash balances are generally as large as 2% to 10% of sales depending on the cash intensity of the business. Judging from Rezidor's historical cash balance between 2011 and 2015 which has averaged 2% of sales, and the high cash intensity of the hotel industry, we will assume an equal level to be sufficient in the LBO. During LBO, transactions and financing fees are typically being paid to the syndicate administrating the debt[21], however as such fees can vary a lot in their set up and their size is almost of negligible, we choose to disregard these fees in this thesis.

Exhibit 49 summarizes section 9 to this point, as it illustrates the sources and uses of funds in the acquisition of Rezidor. The acquisition price will, as we calculated in section 9.1, amount to EUR 821m. Adjusting for net debt and imposing a small cash balance, the acquisition will require us to provide a total of EUR 785m. As motivated in section 9.2, we will be able to receive EUR 506m in debt, which corresponds to 64% of the total capitalisation. The remaining 36% will constitute our equity contribution. This is congruent with a typical LBO deal structure, as described in section 3.5.

Exhibit 49. Sources and Uses of Funds

[21] Transaction fees typically constitute around 1% of the capitalisation, covering costs related to operating the PE firm such as carried interest and management fees. Financing fees are associated with costs to underwriters such as fees for setting up loan agreements with the investment banks, and are normally accounting for 1.5% of the capitalisation. (Anson et al., 2010, p. 107)

Deal Structure			
Uses of Funds			**EURm**
Purchase Price (Equity Value Including Premium)			821
Exisiting Net Debt			-56
Minimum Cash Balance			20
Total Uses			**785**

Sources of Funds	EURm	Multiple of EBITDA	As % of Capitalisation
Senior Debt	425	4,2 x	54%
Term Loan A	*127*	-	*16%*
Term Loan B	*297*	-	*38%*
Subordinated Debt	81	1,0 x	10%
Total Debt	**506**	**5,0 x**	**64%**
Equity Contribution	**279**	**3,0 x**	**36%**
Total Sources	**785**	**-**	**100%**

Source: Own creation

9.3 Free Cash Flows

As we now have determined the debt structure and the interest rates, we can easily calculate the level of interest payments. The level of interest payments is the last piece of information needed to calculate our free cash flows, which we will use in order to pay down the debt.

The free cash flows are derived from EBIT, less interest expense and tax, which corresponds to Rezidor's net income. The tax rate is, as earlier noted, assumed to be 22% for all years in the forecast on the basis of the expected Swedish corporate tax rate. In order to arrive at Rezidor's free cash flows, depreciation and amortisation are added back whereas projected capex and change in operating working capital are subtracted. The interest expense is based on average year debt values as this is more commonly applied in LBOs and considered a more accurate method compared to ending of the year values (Rosenbaum & Pearl, 2012, p.221). Yet the use of average values causes a circular reference as the interest expense is both determining and depending on the ending level of debt. This is solved via enabling iterations in excel and using a switch that breaks the circular reference initially, but can be turned on at a later stage.

We use levered free cash flows, which in contrast to unlevered free cash flows includes interest expenses. This is because we are interested to find the actual amount of cash that will be available for debt repayments (Rosenbaum & Pearl, 2012 p. 111). By not taking interest expenses into account, we would portray a misleading picture of Rezidor's ability to undertake optional debt repayments. On the basis of the projected EBIT derived in our base case, we expect Rezidor to generate the following free cash flows, summarised in exhibit 50. The equal illustration of our upside scenario can be found in appendix H.

Exhibit 50. Projected Free Cash flows

Free Cash Flows	Forecast Period				
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
EBIT	63	72	81	89	95
Interest Expense	-31	-30	-29	-27	-24
Profit Before Tax	**32**	**42**	**52**	**62**	**70**
Tax Expense	-7	-9	-11	-14	-15
Net Income	**25**	**33**	**41**	**48**	**55**
+ Depreciation and Amortisation	35	36	36	37	37
- Capex	-48	-44	-40	-37	-37
- Change in OWC	0	1	1	1	1
Free Cash Flows	**12**	**26**	**38**	**49**	**56**

Source: Own creation

As illustrated in exhibit 50, the free cash flows are expected to increase significantly over the course of the holding period. This is because we expect Rezidor to improve its future profitability, thereby increasing the EBITDA and EBIT margin, which was evident in our cost forecast in section 8.2. Moreover, we expect to generate increased tax shield benefits from the increased leverage. The tax shield is in exhibit 50 reflected by the lower profits before tax caused by the increased interest expense. The impact of the tax shield will decline over the holding period as debt gradually will be repaid. Next, as we have outlined earlier in section 9.3, we are expecting depreciation and amortisation to follow the increase in sales. Regarding capex, we will be able to achieve reductions as a result from a change in the business model. As can be seen in exhibit 50, these reductions will have a positive effect on the forecasted free cash flows. Last, the projected change in operating working capital is assumed to remain at a constant relationship to sales, as described in section 8.2.

9.4 Debt Schedule and Estimation of Net Debt

With regard to the debt structures and interest rate assumptions applied in the LBO, we will devote this section to clarify the debt schedule. For an illustration of our plan for repaying debt, we refer to exhibit 51 below[22].

The top item in the table is named "Beginning Cash Balance" and constitutes the reserves of liquid cash needed for paying immediate expenses during the LBO process. These will be replenished each year after by the item named "Ending Cash Balance" on the bottom of the table. The next item displayed in the table is the total forecasted "Free Cash Flows", which we derived in the previous section. As earlier explained, these free cash flows will be used to repay existing debt. "Minimum Cash Balance" constitutes the cash reserves for maintaining operations during the LBO process. This item will marginally increase over the holding period, as we assume that we will need more cash to for operations if we expect sales to increase. Therefore,

[22] Debt schedule in the upside scenario is displayed in Appendix J.

we set the growth rate of this item to the follow the same pace as sales. As can be understood by their names, “Mandatory Debt Repayments (TLA and TLB)”, these items represent the compulsory amortization of the two senior debt loans TLA and TLB. Following these debt payments, we get to the remaining cash flows, depicted as “Cash Flows Available for Optional Debt Repayments.”

As evident in the table, we intend to use these proceeds to further pay off our debt, particularly the TLA, as it has the highest seniority. In 2019, when the TLA is fully amortized, we will use our remaining “Cash Flows Available for Optional Debt Repayments” for repaying TLB. The outstanding balance of TLB of EUR 245m in 2020 is thereafter assumed to be repaid as a bullet at the time of exit. No repayments of the subordinated loan are expected to occur during the holding period as the loan is less senior than TLA and TLB.[23]

As illustrated by the empty row depicted as “Cash Flows Available after Debt Repayments”, we will use all available cash flows each year to repay debt. The bottom line of the debt schedule shows the “Ending Cash Balance”, which essentially is a mirror of the “Minimum Cash Balance” and will become the “Opening Cash Balance” in the succeeding year. This is also illustrated in the very bottom of exhibit 51, where we summarize the debt schedule. To conclude, we expect Rezidor to generate enough cash to lower the total level of debt from an opening balance of EUR 505m in 2016 to a closing balance of EUR 326m in 2020. Given an ending cash balance of EUR 22m in 2020, we estimate Rezidor’s net debt at the time of exit to equal EUR 305m.

Exhibit 51. Projected Debt Schedule and Net Debt

[23] The precise amortisation schedule for each loan is explained further down the table.

Debt Schedule	Forecast Period				
	2016E	2017E	2018E	2019E	2020E
Beginning Cash Balance	**20**	**20**	**21**	**21**	**21**
+ Free Cash Flows	12	26	38	49	56
- Minimum Cash Balance	20	21	21	21	22
Cash Flows Available for Debt Repayments	**12**	**25**	**38**	**49**	**55**
- Mandatory Debt Repayments (TLA)	-6	-13	-25	-38	-15
- Mandatory Debt Repayments (TLB)	-3	-3	-3	-3	-3
Cash Flows Available for Optional Debt Repayments	**3**	**10**	**10**	**8**	**37**
- Optional Debt Repayments (TLA)	-3	-10	-10	-8	-
- Optional Debt Repayments (TLB)	-	-	-	-	-37
- Optional Debt Repayments (Subordinated Debt)	-	-	-	-	-
Cash Flows Available after Debt Repayments	-	-	-	-	-
Ending Cash Balance	**20**	**21**	**21**	**21**	**22**
TLA					
Amortisation Schedule	5%	10%	20%	30%	35%
Interest Rate	4.33%	4.33%	4.33%	4.33%	4.34%
Beginning Balance	**127**	**118**	**96**	**61**	**15**
- Mandatory Debt Repayments (TLA)	-6	-13	-25	-38	-15
- Optional Debt Repayments (TLA)	-3	-10	-10	-8	-
Ending Balance	**118**	**96**	**61**	**15**	**0**
Interest Expense	5	5	3	2	0
TLB					
Amortisation Schedule	1%	1%	1%	1%	1%
Interest Rate	6.00%	6.00%	6.00%	6.00%	6.01%
Beginning Balance	**297**	**294**	**291**	**288**	**285**
- Mandatory Debt Repayments	-3	-3	-3	-3	-3
- Optional Debt Repayments	-	-	-	-	-37
Ending Balance	**294**	**291**	**288**	**285**	**245**
Interest Expense	18	18	17	17	16
Subordinated Debt					
Amortisation Schedule	-	-	-	-	-
Interest Rate	10.00%	10.00%	10.00%	10.00%	10.00%
Beginning Balance	**81**	**81**	**81**	**81**	**81**
- Optional Debt Repayments	-	-	-	-	-
Ending Balance	**81**	**81**	**81**	**81**	**81**
Interest Expense	8	8	8	8	8
Total Debt Summary					
Beginning Balance	**506**	**494**	**468**	**430**	**382**
- Mandatory Debt Repayments	-9	-16	-28	-41	-18
- Optional Debt Repayments	-3	-10	-10	-8	-37
Total Amortisation	-12	-25	-38	-49	-55
Ending Balance	**494**	**468**	**430**	**382**	**326**
Cash	20	21	21	21	22
Net Debt	**473**	**448**	**409**	**360**	**305**

Source: Own creation

9.5 Return Analysis

Now that we have forecasted Rezidor's future EBITDA and net debt at the time of exit, in two different scenarios, we are able to perform the return analysis. This means that we will decide the exit equity value that we can get from selling Rezidor in year 2020. Given this exit value, we will be then able to compute the cash return of the LBO transaction, as measured in IRR.

9.5.1 Base Case

In LBOs, PE funds generally assume an exit multiple[24] equal to the entry multiple when deciding the selling price of their target in base case scenarios. (Rosenbaum & Pearl, 2012, p.232). This could on the one hand be perceived a little conservative, but we find it on the other hand hard to justify a higher multiple with certainty. Accordingly, we will assume an exit multiple equal to the entry multiple of 7.6x in our base case return analysis.

By applying the exit multiple to the projected EBITDA of EUR 137m in 2020 we arrive at an enterprise value at exit of EUR 1,038m. Deducting Rezidor's net debt, which was estimated to EUR 305m yields an equity value of EUR 733m at exit. A summary of the return profile in the base case scenario, assuming an exit in 2020, is displayed below, exhibit 52. Considering this exit equity value, we would realise an IRR of 21.3% and a cash return of 2.6x.

Exhibit 52. Base Case Return Summary

Return Analysis		
EURm	**2015**	**2020E**
EBITDA	101	137
Entry/Exit Multiple	7.6 x	7.6 x
EV	765	1,038
Net Debt	-56	305
Entry/Exit Equity Value	279	733
IRR	-	21.3%
Cash Return	-	2.6 x

Source: Own creation

9.5.2 Upside Scenario

In accordance with our base case scenario, we will assume an exit multiple equal to our entry multiple in our upside scenario. Nonetheless, the return impact from an exit higher multiple will be addressed in the sensitivity analysis, which will be presented in the following section.

As with the base case, the equity value at entry remains the same, however the estimated EBITDA at exit increases considerably due to the more optimistic forecast estimations. Consequently, the assumed enterprise value at exit becomes larger, and in combination with a lower net debt this results in a considerable higher equity value at exit. As a result, we will realise a higher return than in our base case, which is illustrated in exhibit 53.

Exhibit 53. Upside Scenario Return Summary

[24] As measured in EV/EBITDA

Return Analysis		
EURm	**2015**	**2020E**
EBITDA	101	175
Entry/Exit Multiple	7.6 x	7.6 x
EV	765	1,322
Net Debt	-56	214
Entry/Exit Equity Value	279	1,107
IRR	-	31.7%
Cash Return	-	4.0 x

Source: Own creation

Beyond the assumptions made in our forecast scenarios and the level of the exit multiple, there are other parameters impacting the return potential of the LBO. These parameters include the year of exit and the amount of leverage used. The return impact from changes in these parameters will be tested in a sensitivity analysis in the section that follows.

9.5.3 Sensitivity Analysis

The sensitivity analysis is a critical element when assessing the IRR of a potential LBO. A sensitivity analysis enables us to determine the impact on IRR from changes in assumptions and deviations in the key value drivers in the LBO. In turn, this analysis helps to reduce the uncertainty of undertaking the acquisition of Rezidor. We only conduct a sensitivity analysis on the base case and are not explicitly considering the upside case, because the positive deviations of assumptions in the base case will reflect the results obtained from the upside case. First, we consider the impact of changes in the assumed acquisition premium and exit multiple, which are illustrated in exhibit 54. The highlighted row on the left hand side of this table shows the assumed values that we have applied for our base case scenario. The right hand side of the table shows the different levels of IRR that we obtain by altering the purchase premium as well as the exit multiple.

From the table we can observe that a premium of 20% rather than 30%, would generate an IRR of 27.7%. Similarly, increasing our exit multiple to 8.2x would mean that we reach an IRR of 24.0%. From this we can infer, that paying a low price for Rezidor and receiving a high price in the exit, is a key element for the return. Assuming the opposite would happen in our case, that Rezidor's current shareholder demand a premium of 40%. Such a situation would decrease our expected IRR to a level of 16.4%. Despite having a well-formulated business plan, we would put ourselves in a bad position by paying a too high purchase price as an IRR above the typical 20% threshold would be difficult to achieve without a selling at a higher multiple.

The negative impact on IRR from paying a high purchase price is further amplified by the increasing share of equity contribution required from us in financing the acquisition. This is related to the lower tax shield benefits associated with a decreasing share of debt in the LBO.

Exhibit 54. Sensitivity Analysis of Purchase Premium and Exit Multiple

IRR Assuming Exit in 2020E (EURm)											
EV at Entry	Debt	Equity Contribution	Purchase Premium	Entry Multiple	Exit Multiple						
					6.6 x	6.9 x	7.3 x	7.6 x	7.9 x	8.2 x	8.5 x
690	73%	27%	15%	6.6 x	26.8%	28.5%	30.2%	31.8%	33.3%	34.7%	36.1%
722	70%	30%	20%	6.9 x	22.8%	24.5%	26.1%	27.7%	29.1%	30.5%	31.9%
753	67%	33%	25%	7.3 x	19.5%	21.2%	22.8%	24.2%	25.7%	27.0%	28.3%
785	64%	36%	30%	7.6 x	16.7%	18.3%	19.8%	21.3%	22.7%	24.0%	25.3%
816	62%	38%	35%	7.9 x	14.2%	15.8%	17.3%	18.7%	20.1%	21.4%	22.6%
848	60%	40%	40%	8.2 x	12.0%	13.6%	15.1%	16.4%	17.8%	19.1%	20.3%
880	57%	43%	45%	8.5 x	10.1%	11.6%	13.0%	14.4%	15.7%	17.0%	18.2%

Source: Own creation

Next, we examine the impact on from sensitizing the degree of leverage applied in the LBO and the assumed year of exit, holding all other factors constant. Exhibit 55 shows two tables, where the left hand table shows different scenarios, assuming a higher leverage, whereas the right hand table shows what impact an earlier exit will have on the IRR. As before, the highlighted cells show our base case scenario.

Presuming that we would be able to obtain a debt multiple of 6.0x, increasing the amount of leverage by almost 20%, and decreasing our equity contribution with about 36%, our IRR would become as high as 31.3%. In other words, the level of debt in the debt/capital ratio is a critical aspect for achieving a high IRR, if things go well. Increased leverage puts the transaction under a higher pressure, due to the increased risk of financial distress. However, we should also point out that such debt/equity ratios as displayed in the bottom row of the table is not uncommon among LBOs and that this has been a key determinant of success for many LBOs, such as our case example of Hilton. With the increased amount of leverage comes a larger tax shield benefit and a greater return on the equity contribution form the PE fund. (Rosenbaum & Pearl, 2012, p.175). Concerning the different scenarios for an earlier exit than in year 2020, we can see that the impact is not as large, because an earlier exit implies a shorter time frame for repaying debt levels, converting debt into equity.

Exhibit 55. Sensitivity Analysis of Leverage and Year of Exit

IRR Assuming Exit in 2020E				
Debt/ EBITDA	Debt	Equity Contribution	IRR	Cash Return
4.0 x	404	380	15.3%	2.0 x
4.5 x	455	330	18.0%	2.3 x
5.0 x	506	279	21.3%	2.6 x
5.5 x	556	229	25.5%	3.1 x
6.0 x	607	178	31.3%	3.9 x

IRR Assuming Entry Multiple of 7.6 x EBITDA 2015					
Exit	Exit Year				
Multiple	2016E	2017E	2018E	2019E	2020E
6.9 x	-2.9%	12.8%	17.0%	18.1%	18.3%
7.4 x	13.4%	20.4%	21.4%	21.0%	20.4%
7.6 x	21.1%	23.8%	23.4%	22.3%	21.3%
8.0 x	37.8%	30.9%	27.4%	25.0%	23.2%
8.5 x	57.0%	38.5%	31.8%	27.9%	25.3%

Source: Own creation

Another important determinant for the outcome of an LBO transaction is the assumption made concerning revenue growth. The highlighted row in exhibit 56 displays our forecasted revenue growth for each year in our base case scenario, as well as the IRR that we expect to get from the exit in 2020. Speculating that a sudden negative shock in hotel demand, as was the case following the event of 9/11, we can see that this would seriously affect our expected IRR. For instance, a 1% lower annual growth rate in sales would imply an IRR of only 13.1%. However, we should note at this point that our forecast of revenues in our base case scenario have been relatively conservative. Thus, assuming positive deviations from our revenue forecast, we can see that there is a high potential of achieving a higher IRR. With a more optimistic growth outlook, the estimated IRR increases significantly as a result of a higher EBITDA, leading to faster debt repayments, turning debt into equity value.

Exhibit 56. Sensitivity Analysis of Revenue Growth Assumptions

Change in Revenue Growth's Impact on IRR											
Change	Revenue Growth					EBITDA	EV	Net Debt	Equity	IRR	Cash
in Growth	2016E	2017E	2018E	2019E	2020E	at Exit	at Exit	at Exit	at Exit		Return
-2.0%	-0.3%	-0.2%	-0.5%	-0.7%	-0.7%	94	713	406	307	1.9%	1.1 x
-1.5%	0.2%	0.3%	0.0%	-0.2%	-0.2%	105	792	381	411	8.0%	1.5 x
-1.0%	0.7%	0.8%	0.5%	0.3%	0.3%	115	872	356	516	13.1%	1.8 x
-0.5%	1.2%	1.3%	1.0%	0.8%	0.8%	126	954	331	624	17.4%	2.2 x
0.0%	1.7%	1.8%	1.5%	1.3%	1.3%	137	1,038	305	733	21.3%	2.6 x
0.5%	2.2%	2.3%	2.0%	1.8%	1.8%	148	1,123	278	845	24.8%	3.0 x
1.0%	2.7%	2.8%	2.5%	2.3%	2.3%	160	1,210	252	959	28.0%	3.4 x
1.5%	3.2%	3.3%	3.0%	2.8%	2.8%	172	1,299	224	1,075	30.9%	3.8 x
2.0%	3.7%	3.8%	3.5%	3.3%	3.3%	184	1,390	197	1,193	33.7%	4.3 x

Source: Own creation

Last, we assess the robustness of our assumptions about cost improvements and EBITDA margin development. Similar to exhibit 56, exhibit 57 displays our forecasted base case scenario in the highlighted row. On the left hand side, the table illustrates possible changes in EBITDA margin, while on the right hand side, we can see its impact on IRR. As with the revenue growth projections, a negative deviation from our expected EBITDA margin yields a lower level of IRR, the impact however is not as large as with an equivalent drop in sales growth. This is because of the fact that the EBITDA margin also includes operating costs, which is not the case with revenues.

Exhibit 57. Sensitivity Analysis of EBITDA Margin Assumptions

Change in EBITDA Margin's Impact on IRR											
Change	EBITDA Margin					EBITDA	EV	Net Debt	Equity	IRR	Cash
in Margin	2016E	2017E	2018E	2019E	2020E	at Exit	at Exit	at Exit	at Exit		Return
-2.0%	8.6%	9.2%	9.8%	10.3%	10.8%	116	875	394	481	11.5%	1.7 x
-1.5%	9.1%	9.7%	10.3%	10.8%	11.3%	121	916	372	544	14.3%	1.9 x
-1.0%	9.6%	10.2%	10.8%	11.3%	11.8%	126	957	349	607	16.8%	2.2 x
-0.5%	10.1%	10.7%	11.3%	11.8%	12.3%	132	997	327	670	19.1%	2.4 x
0.0%	10.6%	11.2%	11.8%	12.3%	12.8%	137	1,038	305	733	21.3%	2.6 x
0.5%	11.1%	11.7%	12.3%	12.8%	13.3%	143	1,079	282	796	23.3%	2.9 x
1.0%	11.6%	12.2%	12.8%	13.3%	13.8%	148	1,119	260	860	25.2%	3.1 x
1.5%	12.1%	12.7%	13.3%	13.8%	14.3%	153	1,160	237	923	27.0%	3.3 x
2.0%	12.6%	13.2%	13.8%	14.3%	14.8%	159	1,201	214	986	28.7%	3.5 x

Source: Own creation

9.6 Exit Considerations

With an approximation of the IRR profile and a selling price that would be required for the LBO to be considered successful, we turn to the divestment stage and consider how an exit of Rezidor could be designed. As we addressed in section 3.7, the exit strategy forms a key element of the LBO transaction as it ensures that the investors will be able to realise a return on their investment. After all, the returns are not realized until the LBO target is sold off. In general, PE funds have more than one option for how to exit and therefore select the most suitable one given the prevailing market conditions. As a result, we will examine the possibility of exiting Rezidor in an IPO or in a sale to a strategic buyer.

9.6.1 IPO

When deciding to exit through an IPO, the market timing is the most critical aspect. Moreover, PE firms consider aspects with regards to location of listing, cornerstone investors and the potential discount offered to public investors. Despite requiring higher transaction costs compared to an outright sale, IPOs are often considered to be the most popular route as they often generate significant values in booming markets (Baker et al., 2015 p.535). As for the exit of Rezidor executed through an IPO, we would map out the following plan:

First, we would assess whether the prevailing market conditions are in favour of an IPO by conducting a careful assessment of the macroeconomic environment. In contrast to the market of M&A's, the IPO market is more susceptible to volatility and the general economic sentiment. A sudden change in the economic conditions close to the day of listing could have adverse impacts on the exit as it could result in a lower listing price or to postpone the IPO (EY, 2016). Moreover, there is a risk of oversupplying the market if we would divest all our shares in an IPO. For this reason, many PE firms choose to remain large block holding shareholders, which also signals that the firm believes in the prospects of its LBO target. An obvious risk in that case would be that we would face a trade restriction, preventing us from selling additional shares for a period of 6 to 12 months following the IPO.[25] (Povaly, 2007 p.122) This leaves us with an additional risk as we during this period would have to bear market risk. This risk exposure could on the other hand yield benefits if the stock price would increase post the IPO. Referring to the Hilton transaction, Blackstone retained a 67% ownership after the IPO and managed to get a 26% higher return from selling shares after the expiration of the lock-up period. (Dulaney, 2014)

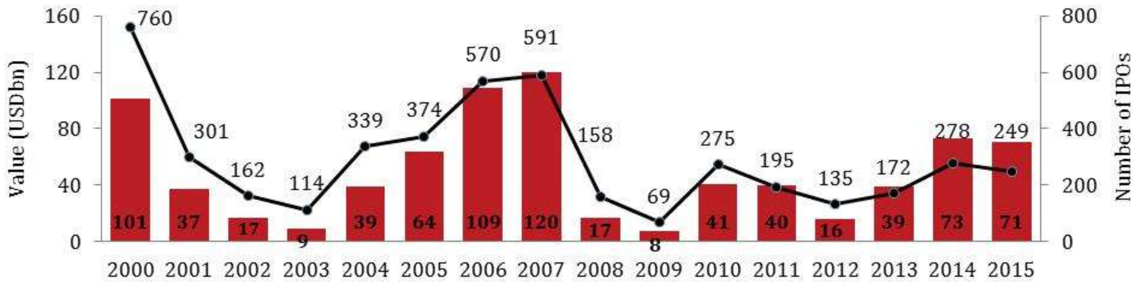
Assessing the sentiment of the IPO market, we would focus on the development of the major European stock market indices, such as the Euro STOXX 50 and the OMX S30. We would further analyse the development of government bond yields and the level of the volatility index, VIX. Ideally, stock markets would indicate stability and increasing trends whereas bond yields would remain low forcing investors to allocate funds into equities. VIX, which corresponds to the implied volatility on the S&P 500 index options is a measure of investors' expectations about future volatility in the market. Generally, a level below 20 is considered a sign of a calm market, while a level above 30 implies uncertainty (Investopedia, 2003a). A low level in the VIX index is essential when pursuing an IPO as investors generally revert to safer investments in disturbed market periods.

We would thereafter consider the IPO activity and performance of the prevailing IPO market. As Rezidor has a history of being a Scandinavian hotel operator and has always been based in Sweden, where most of its labour force is located, we would be likely to proceed with a listing on the OMX Stockholm stock exchange.

Specifically, we would expect to list Rezidor on the OMX midcap cap list as the estimated equity value at exit remains below a billion euro (Nasdaq, 2012). As a result, we would primarily focus on the development and pipeline of IPO's in the Nordic region. All else being equal, a high IPO pipeline is a clear attractive aspect for such a route of exit. An overview of the development in the number of IPO's in the European and the Nordic region between 2000 and 2015 is displayed below, exhibit 58 and 59.

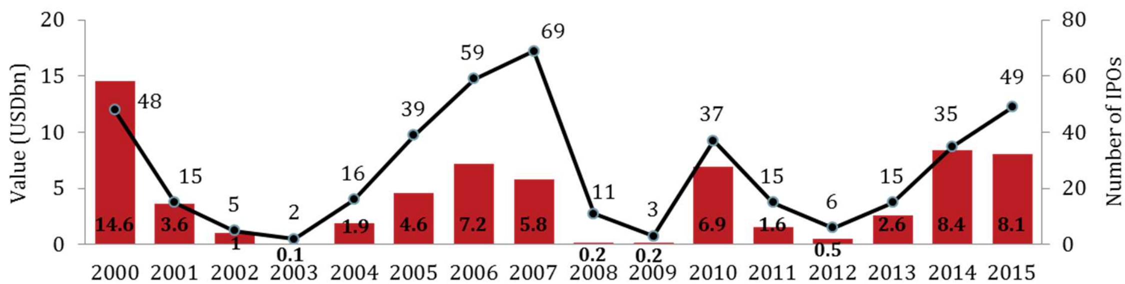
[25] Such lock up periods are imposed on firms that have decided to divest less than 100% of their shares in order to prevent the company from selling shares too quickly after a company goes public. A company trying to unload the remaining part of their shares in the first week of trading could send the stock downward, to the detriment of all shareholders.

Exhibit 58. European IPO's 2000-2015



Source: Thomson Reuters (2016), Own creation

Exhibit 59. Nordic IPO's 2000-2015



Source: Thomson Reuters (2016), Own creation

As portrayed by the graphs, the number of IPOs varies relatively much from year to year as an effect of external shocks caused by changes in the economic sentiment. For instance, during the financial crisis of 2008 the number of IPOs declined radically as an effect of plunging stock markets and increased volatility. In 2012, the market for IPOs deteriorated due to concerns about the global economy and the European debt crisis which caused increased volatility and falling stock prices as investors reverted to safe have assets such as gold. (Stewart et al, 2012)
A lead investment bank would be hired in order to assist in determining the market sentiment, coordinating the process and build the book ahead of the day of listing. In building the book, which is a procedure of determining a suitable listing price considering the demand from institutional investors (Investopedia, 2003b) we would stress the importance of attracting reputable investment and pension funds to commit to acquiring shares in the IPO. This would help in portraying Rezidor as an attractive investment being sought after by professional investors. In combination with offering an appropriate discount, we would thereby increase the chance of the issue being oversubscribed and the execution of a successful IPO exit.

In IPO's, discounts are typically offered in order to attract attention and increase the appetite from investors. The size of the discount would be decided upon recent discount levels in Nordic IPO's, but also taking the requirements from cornerstone investors into account. Bodnaruk et al.

(2007) found that the average discount from 124 IPOs in Sweden between 1995 and 2001 was 14.2%. (Bodnaruk et al, 2007). As a reference to the hotel industry, Blackstone offered a discount of 7.5% for selling Hilton, which lead to the stock being oversubscribed. (Dulaney, 2014)

9.6.2 Strategic Sale

As opposed to the exit through an IPO, a strategic sale usually involves a full exit i.e. we would sell 100% of Rezidor. In addition, a strategic sale would imply a faster exit route, eliminating the market exposure that PE firms face when deciding to sell remaining blocks of shares at a later point after the IPO. The strategic sale is also less sensible to the state of the overall economic activity than the IPO as the selling price is more dependent on the synergies that the specific buyer would get from combining activities. Nevertheless, as stock prices in the hotel industry are affected by the market demand for hotel services, which in turn is driven by the overall economic activity, there is a certain aspect of timing to the exit of a strategic sale as well.

A common strategic sale process contains four stages, in the first, the PE company determines a fair value of the company it intends to sell. In the second stage, potential buyers are identified, contacted and provided information memoranda. Stage three is where a company informs the PE fund of their interest and makes an indicative offer. In stage four, a complete due diligence is carried out and negotiations between the potential acquirer and the PE fund take place, before agreeing to a purchase price (McDonald & Lam, 2014). During this stage, PE fund provides the potential acquirer with confidential information, which involves sensitive financials and future forecasts. Sharing this information implies a risk for the PE firm, given that there is a risk that the transaction will not be completed. However, it is in the PE firm's interest to help reduce the information asymmetry faced by the buyer. (ibid, 2014)

Now, as we have already determined the selling price of Rezidor, corresponding to EV/EBITDA 7.6x, we have completed the first stage of the sale process. In the remaining part of this section we will discuss who the potential buyers could be. As we described in section 4.5.2, merger activity in the hotel industry has been rising in the recent past. Acquiring hotel companies are seeking the value of diversification of their brand segments and geographic operations as well improving the value proposition of their loyalty program by expanding their hotel network. For instance, addressing the rationale behind the acquisition of Starwood, Marriott's CEO Arne Sorenson claimed that "this greater scale should offer a wider choice of brands to consumers." Loyalty programs become increasingly important as members spend more and stay more frequently than non-members. As earlier noted, what makes a loyalty program attractive is predominantly their geographic spread, which appeals to both business and leisure customers. For these reasons, we concentrate this buyer selection process on competitors that have low presence in Rezidor's markets and brand segments.

At present, there is no obvious buyer among the peer group. Although being less present in Africa, the British market leader IHG has already a considerable hotel portfolio in Europe in the same segments as Rezidor's dominant brands, Radisson Blu and Park Inn. Hilton is also well established in the EMEA region, having for many years pursued an aggressive international expansion under the ownership of Blackstone. In terms of its brand portfolio, it is also very similar to Rezidor. The same holds for the two remaining companies, Marriott and Starwood, who will soon combine their forces and become the world's largest hotel company. As Starwood today has a very diversified hotel portfolio, we believe that Marriott would be satisfied with its combined portfolio. Thus, we believe that other players among the top 10 largest hotel companies would be more willing to buy Rezidor.

The world's fourth largest hotel company Wyndham seems to fit into the above mentioned criteria. In the past 5 years, it has been growing at a slower pace than its top competitors and has a relatively homogenous brand portfolio, mostly serving the economy and midscale segments (Wyndham, 2014). Rezidor, being strong in the upper upscale segment as well as in the upper midscale segment would be a good fit in this respect. In addition, hotel rooms located in Europe, Middle East and Africa only account for 8% of Wyndham's total portfolio, meaning that Wyndham would also benefit from a geographic diversification in the event of acquiring Rezidor.

Another potential acquirer is Homeinns, which is the tenth largest hotel company as well as being China's market leader. Operating a portfolio exclusively containing hotels in the economy segment in China, we see several reasons why the company would be interested in buying Rezidor (Homeinn, 2015). By acquiring Rezidor, Homeinns would effectively diversify its highly homogenous revenue streams, hedge the impact of the sharing economy on the economy segment and increase its global hotel network.

10 Section – Conclusion

In the following section, we elaborate on our research process and discuss our main findings. Then, we conclude our thesis by answering our problem statement.

10.1 Discussion

Having defined Rezidor as our target company, we soon realized that there are several aspects that make Rezidor an interesting for an LBO process.

Carlson Hotels, the current majority owner of Rezidor has recently announced that it is investigating the possibilities of an exit. Moreover, Rezidor is in the possession of a well-recognised brand portfolio, which in the future will become increasingly important as growth in traditional markets is driven by branded hotel chains. The company is a big player in many traditional markets in Western Europe, but a rather small player in the global context. The industry is currently undergoing a consolidation phase, driven by the pursuit of economies scale, where the largest players are acquiring companies of larger sizes than Rezidor's. In order to survive in such a competitive environment, we explored Rezidor's opportunities to grow organically.

We carefully assessed Rezidor's market position in traditional markets as well as in emerging markets. We discovered that Rezidor since long has been opening new hotels and building relationships in fast growing and unexplored markets in Sub Saharan Africa. The decision to enter this region at an early stage seems to be valuable in the future. The region is characterized by increasing economic activity, despite the low prevailing commodity prices. The economic growth is driven by increased diversification and a growing middle class, in turn creating a higher demand for domestic goods and services. Considering that most of the branded hotel operators in the region are currently targeting either luxury or upscale customers, we see an opportunity to expand in the midscale segment, in which Rezidor's brand Park Inn would fit well for the purpose.

Another shift in the global hotel demand is the rising importance of the so-called Millennial Travellers. By 2020, we can expect that these customers will account for half of the global hotel demand and to be ready for this shift, Rezidor has recently launched a new brand, Radisson Red. Also in this regard, we see an opportunity for Rezidor to become a first mover by quickly introducing the brand to selected markets, preferably markets with particularly young and trend conscious populations.

We could see signs that growing market shares is a precondition for survival. Hence, we investigated the impact of firm size on profitability using a sample of 12 firms between 2012 and 2013, and found an interesting relationship. EBIT margins of hotel companies seem to correlate with firm size, implying that profitability in the hotel industry is impacted by scale efficiencies. Normally, companies that achieve significant economies of scales are companies producing highly standardised goods, which is necessarily not expected in the hotel industry. However, there are some aspects in the hotel industry in which scale economies are evident. For instance overhead costs, as well as the maintenance costs of hotels, can be reduced by firm size. Yet, the largest scale efficiencies are reaped by attaining economies of scope, more concretely by the creation of a loyal customer base. Through an attractive loyalty programs, the largest hotel operators have been able to retain customers and increase the spending per customer in the last years. One important reason why large firms have been more successful with such loyalty programs is because of their extensive hotel network. Rezidor has a smaller hotel portfolio compared to giants such as IHG and Hilton, but combined with its owner Carlson, it is still a top 10 player. Thus, by improving other aspects in the value proposition of its loyalty program, Rezidor may still be able to have an equally attractive loyalty program as IHG and Hilton for instance.

Another apparent aspect in the hotel industry that is closely related to profitability is the mix of franchised, managed and leased/owned hotels in the hotel portfolio. In the hotel industry, this mix is commonly referred to the business model. Rezidor has in recent years grown by predominately opening franchised and managed hotels. Besides constituting a significantly lower risk compared to leased hotels, fee-based contracts are on average considerably more profitable and require a lower level of capex. We see the pros of franchised and managed contracts to outweigh the cons. However, Rezidor should be aware of the risk of brand dilution from misconducting franchisees and management companies. Next, we incorporated the above mentioned findings in a business plan which pointed out the following value enhancing measures that we would aim to undertake during our ownership of Rezidor:

- *Increased tax shield*
- *Optimize the board composition and executive compensation*
- *Expansion in Sub-Saharan Africa primarily in the upper midscale segment*
- *Expansion of Radisson Red hotels*
- *Accelerate the rebalancing of Rezidor's business model*

- *Improved loyalty program*

By implementing these measures and taking our predictions of the future market demand into account, we estimate an annual average of 1.5% growth in revenues, yielding an increased EBITDA margin of 28% over the holding period.[26] These results confirmed our belief that Rezidor is an appropriate target for an LBO transaction and we were therefore interested in examining how a deal could be structured.

We calculated the purchase price and debt capacity by collecting typical EV/EBITDA and Debt/EBITDA multiples of recent LBO transactions. We further portioned the leverage into different tranches and estimated appropriate costs of debt by applying Moody's methodology for assessing a hotel company's creditworthiness. We thereafter computed the expected free cash flows, subtracted the mandatory debt amortizations and found that we would have additional cash flows available for supplementary debt repayments. Using these funds to accelerate our debt schedule would imply that we could lower our net debt from EUR 473m in 2015 to EUR 305m in 2020. This allowed us to derive an IRR of our LBO transaction, amounting to 21.3% in our base case scenario. The IRR will be further debated in our conclusion.

The final part of this thesis was devoted to consider two possible exit options. This is an important aspect of an LBO, since the investment is not monetized until the shares are sold. We discussed the advantages and disadvantages of an IPO, pointing out the fact that the success is highly dependent on the prevailing market sentiments. The value generated by the second option, the strategic sale, is more dependent on the specific match between the buyer and the target as a result of synergies.

10.2 Conclusion

The final part of this thesis aims to answer to the problem statement that we formulated in the introduction: *What are the primary activities undertaken in leveraged buyouts and how do they impact the exit value and IRR in a hypothetical transaction?*

Over the course of the thesis, we have covered essential aspects of the leveraged buyout process. As for the acquisition stage, we examined the typical characteristics that constitute strong LBO candidates, from which we created a set of screening criteria for identifying the most appropriate target company. Further, we structured the debt and derived a realistic

[26] These estimates hold for the base case scenario

interest rate, based on an estimation of our targets creditworthiness. Last in the acquisition stage, we identified a number of areas for improvements and formulated a business plan that could be implemented in the holding stage. In the divestment stage, we calculated common return measures including the IRR and addressed the primary exit strategies in LBO transactions involving IPO and M&As.

When applying our theoretical framework in the hypothetical transaction, we find that an IRR of 21.3% can be achieved on the basis of conservative forward looking projections. Undoubtedly, the acquisition price paid to acquire the target and the amount of debt applied in structuring the deal largely impacts the IRR. An increased debt utilisation would help to improve the IRR potential but would however also increase the risk of undertaking the LBO. Assumptions about value materialisation during the holding period in the form of growth and profitability improvements also have a significant effect on the IRR. Altering our conservative projections to a more optimistic outlook would imply that a higher IRR in the range between 23% and 32% could be achieved. Thereby, it is essential to lay out scenarios and sensitise key parameters for various levels in assessing the feasibility of an LBO determined by the IRR. The assumed year of exit and multiple also impacts the IRR significantly and should be considered and sensitised accordingly.

We conclude in this thesis that selecting an LBO target based on a set of academically derived parameters and an implementing typical value enhancing strategies could realistically generate an IRR above 20%.

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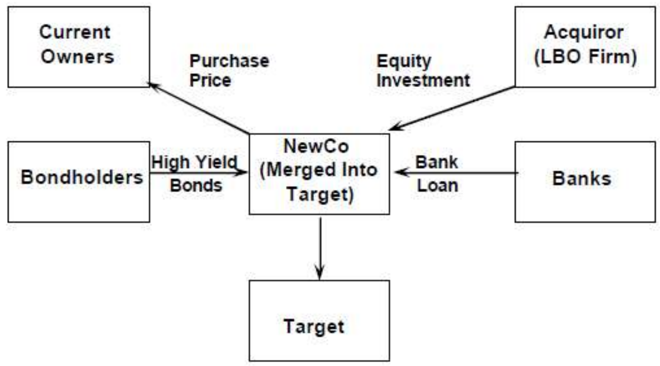
Appendix

Appendix A. – Newco Deal Structure



Appendix B. Rezidor Reported & Analytical Financial Statements

Rezidor Hotel group reported income statement					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
Revenue	**864**	**924**	**920**	**937**	**997**
Costs of goods sold for Food & Drinks and other related expenses	-65	-67	-55	-56	-58
Personnel cost and contract labour	-303	-316	-315	-325	-343
Other operating expenses	-208	-225	-218	-228	-239
Insurance of properties and property tax	-14	-16	-15	-14	-16
EBITDAR	**275**	**300**	**317**	**314**	**341**
Rental expense	-242	-252	-238	-242	-243
Share of income in associates and joint ventures	3	2	2	-1	3
EBITDA	**35**	**51**	**81**	**71**	**101**
Depreciation and amortisation	-32	-30	-30	-33	-37
Write-downs and reversal of write-downs	-12	-12	-5	-8	-6
Costs due to termination/restructuring of contracts	-	-9	-2	-	-1
Loss on sale of shares and tangible fixed assets	-0	-	-	-0	0
EBIT	**-8**	**-1**	**44**	**31**	**57**
Financial income	1	1	1	1	2
Financial expense	-2	-2	-3	-2	-3
Profit before tax	**-9**	**-2**	**42**	**29**	**57**
Income tax expense	-3	-15	-19	-15	-22
Profit for the year	**-12**	**-17**	**23**	**14**	**34**
Non-controlling interest	-	-	-	-	-
Profit for the year attributable to owners of the parent company	**-12**	**-17**	**23**	**14**	**34**

Rezidor Hotel group reported balance sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
ASSETS					
Licenses and related rights	47	46	45	44	42
Other intangible assets	26	26	23	24	22
Total intangible assets	**74**	**72**	**68**	**68**	**65**
Fixed installations in leased properties	35	44	48	51	52
Machinery and equipment	62	56	69	73	86
Investments in progress	12	12	9	13	32
Total tangible assets	**109**	**112**	**125**	**137**	**171**
Investments in associated companies	3	3	3	3	3
Investments in joint ventures	1	1	-	-	-
Total investments in associated companies and joint ventures	5	4	3	3	3
Other shares and participations	7	6	5	5	5
Pension funds, net	9	8	-	-	-
Other long-term interest-bearing receivables	13	14	4	7	8
Other long-term non-interest-bearing receivables	0	4	2	3	6
Total other long-term receivables	13	18	7	10	14
Total financial assets	**34**	**36**	**15**	**18**	**22**
Deferred tax assets	32	29	29	27	22
Total non-current assets	**249**	**250**	**237**	**250**	**279**
Inventories	5	5	5	5	5
Accounts receivable	39	44	44	45	41
Current tax assets	7	11	15	22	12
Other current interest-bearing receivables	1	0	1	0	3
Other current non-interest-bearing receivables	57	53	56	53	64
Total other current receivables	104	109	116	120	118
Derivative financial instruments	-	-	0	0	-
Other short-term investments	4	4	4	4	2
Cash and cash equivalents	10	9	7	36	38
Assets classified as held for sale	3	-	13	12	22
Total current assets	**125**	**127**	**145**	**177**	**186**
Total assets	**374**	**376**	**382**	**428**	**464**
EQUITY AND LIABILITIES					
EQUITY					
Share capital	10	10	10	12	12
Other paid in capital	120	120	120	177	177
Reserves	17	19	11	6	4
Retained earnings including profit for the year	18	0	14	24	54
Equity attributable to owners of the company	165	150	155	219	247
Non controlling interests	0	0	0	0	0
Total equity	**165**	**150**	**155**	**219**	**247**
LIABILITIES					
Deferred tax liabilities	16	17	16	16	15
Retirement benefit obligations	2	2	7	6	6
Provisions	1	6	0	1	0
Other long-term interest-bearing liabilities	6	7	6	6	6
Other long-term non-interest-bearing liabilities	4	10	12	-	12
Total other long-term liabilities	12	23	19	19	18
Total non-current liabilities	**30**	**42**	**41**	**42**	**39**
Accounts payable	34	35	39	35	38
Current tax liabilities	10	7	11	11	7
Provisions	-	-	3	4	3
Other current interest-bearing liabilities	8	26	18	0	0
Derivative financial instruments	-	-	0	0	0
Other current non-interest-bearing liabilities	120	117	116	116	0
Total other current liabilities	172	185	186	167	174
Liabilities classified as held for sale	-	-	-	-	5
Total current liabilities	**172**	**185**	**186**	**167**	**179**
Total liabilities	**209**	**226**	**227**	**208**	**217**
Total liabilities and equity	**374**	**376**	**382**	**428**	**464**

Rezidor Hotel Group Analytical Income Statement					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Sales revenue	**864.2**	**923.7**	**919.5**	**937.3**	**997.0**
Income from associates	2.6	2.4	2.1	-0.6	3.2
Total operating revenue	**866.9**	**926.0**	**921.6**	**936.7**	**1,000.2**
Operating expenses	-321.1	-334.1	-308.3	-311.9	-316.7
Administrative expenses	-303.1	-315.8	-315.1	-325.2	-343.0
Other expenses	-207.5	-225.4	-217.6	-228.4	-239.4
EBITDA	**35.1**	**50.8**	**80.7**	**71.3**	**101.1**
Depreciation and amortisation	-31.6	-30.1	-29.7	-33.0	-37.3
Impairment charges	-11.6	-12.3	-5.0	-7.7	-5.8
Restructuring and other special operating charges	0.4	-9.4	-1.9	0.0	-0.7
EBIT	**-7.7**	**-0.9**	**44.2**	**30.7**	**57.3**
Tax on EBIT	-3.5	-15.2	-19.6	-15.4	-22.6
NOPAT	**-11.2**	**-16.1**	**24.5**	**15.3**	**34.7**
FINANCIALS					
Interest expense	-2.4	-2.2	-2.6	-2.4	-2.6
Interest income	1.4	1.2	0.9	0.9	1.9
Net financial expense before special financial items	**-1.0**	**-1.0**	**-1.7**	**-1.5**	**-0.7**
Loss on early extinguishment of debt, net	-	-	-	-	-
Loss on sale of shares and tangible fixed assets	0.4	-	-	-0.0	0.4
Net financial expense before tax	**-1.0**	**-1.0**	**-1.7**	**-1.5**	**-0.7**
Tax on net financial expense (tax shield)	0.3	0.2	0.4	0.3	0.2
Net financial expense after tax	**-0.7**	**-0.8**	**-1.4**	**-1.2**	**-0.5**
Net profit for the year	**-11.9**	**-16.8**	**23.2**	**14.2**	**34.2**
TAX ADJUSTMENTS					
Statutory tax rate (Sweden)	26.3%	22.0%	22.0%	22.0%	22.0%
Reported tax	-3	-15	-19	-15	-22
Tax shield	0.3	0.2	0.4	0.3	0.2
Tax on EBIT	**-3.5**	**-15.2**	**-19.6**	**-15.4**	**-22.6**

Rezidor Hotel Group Analytical Balance Sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Non-current assets					
Licenses and related rights	47.5	46.3	45.1	44.0	42.4
Other intangible assets	26.2	25.8	23.0	24.2	22.2
Fixed installations in leased properties	35.4	44.3	47.8	51.2	52.4
Machinery and equipment	62.2	55.9	68.7	73.3	86.3
Investments in progress	11.8	12.2	8.7	12.7	31.8
Investments in associated companies and Joint Ventures	4.6	4.4	2.9	2.5	2.9
Other shares and participations	7.2	6.2	5.2	5.2	5.2
Other long-term non-interest-bearing receivables	0.3	4.2	2.4	2.9	5.9
Deferred tax assets	31.6	28.9	28.6	27.0	21.7
Total non-current operating assets	**226.8**	**228.3**	**232.5**	**243.0**	**270.8**
Current assets					
Inventories	4.7	5.0	4.8	5.1	5.0
Accounts receivable	39.0	44.3	44.1	45.2	40.7
Current tax assets	7.0	10.8	15.3	21.9	11.6
Other current non-interest-bearing receivables	56.6	53.3	55.8	52.9	63.8
Total current operating assets	**107.4**	**113.3**	**120.0**	**125.1**	**121.1**
Non-current liabilities					
Deferred tax liabilities	15.7	16.6	15.6	16.5	15.4
Provisions, short-term	1.2	6.2	0.5	1.2	0.0
Other long-term non-interest-bearing liabilities	4.3	9.9	11.9	12.1	11.9
Total non-current operating liabilities	**21.3**	**32.7**	**27.9**	**29.7**	**27.3**
Current liabilities					
Accounts payable	34.2	35.1	38.5	35.5	38.0
Current tax liabilities	9.5	6.9	10.6	11.0	6.8
Provisions, long-term	0.0	0.0	2.6	4.2	2.9
Other current non-interest-bearing liabilities	120.4	116.8	116.5	115.9	126.6
Total current operating liabilities	**164.1**	**158.7**	**168.1**	**166.5**	**174.3**
Total non-interest bearing debt (operating liabilities)	**185.4**	**191.5**	**196.1**	**196.3**	**201.6**
Operating working capital	**-56.7**	**-45.4**	**-48.2**	**-41.5**	**-53.2**
Net operating assets (invested capital)	**148.8**	**150.1**	**156.4**	**171.8**	**190.3**

FINANCIALS					
Equity					
Share capital	10.0	10.0	10.0	11.6	11.6
Other paid in capital	120.3	120.3	120.3	177.1	177.1
Reserves	16.5	19.4	11.0	6.2	3.5
Retained earnings including profit for the year	17.9	0.2	13.6	24.4	54.4
Non controlling interests	0.0	0.0	0.0	0.0	0.0
Total equity	**164.7**	**149.9**	**155.0**	**219.4**	**246.7**
Interest-bearing debt					
Other long-term interest-bearing liabilities	6.9	6.9	6.3	6.0	5.7
Other current interest-bearing liabilities	7.9	26.2	17.5	0.0	0.0
Derivative financial instruments	0.0	0.0	0.1	0.1	0.1
Retirement benefit obligations	2.2	1.9	6.7	5.7	5.6
Liabilities classified as held for sale	6.8	0.0	0.0	0.0	4.6
Total interest-bearing debt	**23.7**	**35.0**	**30.7**	**11.8**	**16.0**
Interest-bearing assets					
Pension funds, net	9.2	7.7	0.0	0.0	0.0
Other long-term interest-bearing receivables	12.8	13.8	4.1	7.1	7.8
Other current interest-bearing receivables	1.3	0.3	0.7	0.4	2.5
Derivative financial instruments	0.0	0.0	0.4	0.5	0.3
Other short-term investments	3.5	4.2	4.1	3.9	2.0
Cash and cash equivalents	9.8	8.6	6.9	35.5	37.7
Assets classified as held for sale	3.1	0.0	12.9	12.0	22.1
Total interest-bearing assets	**39.6**	**34.7**	**29.2**	**59.4**	**72.4**
Net-interest bearing debt	**-15.9**	**0.3**	**1.4**	**-47.6**	**-56.4**
Net financial assets (invested capital)	**148.8**	**150.1**	**156.4**	**171.8**	**190.3**

Appendix C. IHG Reported & Analytical Financial Statements

International Hotel Group reported income statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
Revenues	**1 768**	**1 835**	**1 903**	**1 858**	**1 803**
Cost of sales	-771	-772	-784	-741	-640
Administrative expenses	-361	-372	-374	-382	-395
Share of (losses)/profits of associates and joint ventures	1	3	2	-4	-3
Other operating income and expenses	10	5	6	16	11
Operating profit before interest taxes and depreciation	**647**	**699**	**753**	**747**	**776**
Depreciation and amortisation	-99	-94	-85	-96	-96
Impairment charges	-	-	-	-	-
Operating profit	**548**	**605**	**668**	**651**	**680**
Financial income	2	3	5	3	5
Financial expenses	-64	-57	-78	-83	-92
Profit before tax	**486**	**551**	**595**	**571**	**593**
Tax	-117	-151	-175	-179	-180
Profit for the year from continuing operations	**369**	**400**	**420**	**392**	**413**
Equity holders of the parent	369	399	418	391	411
Non-controlling interest	-	1	2	1	2
Net profit	**369**	**400**	**420**	**392**	**413**

International Hotel Group reported balance sheet					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
ASSETS					
Property, plant and equipment	1 362	1 056	1 169	741	428
Goodwill and other intangible assets	400	447	518	643	1 226
Investment in associates and joint ventures	87	84	85	116	136
Trade and other receivables	-	-	-	3	3
Retirement benefit assets	21	99	7	8	-
Other financial assets	156	155	236	252	284
Non-current tax receivable	41	24	16	34	37
Deferred tax assets	106	204	108	87	49
Total non-current assets	**2 173**	**2 069**	**2 139**	**1 884**	**2 163**
Inventories	4	4	4	3	3
Current trade and other receivables	369	422	423	448	462
Current tax receivable	20	31	12	4	4
Derivative financial instruments	3	2	1	2	-
Other financial assets	-	6	12	5	-
Cash and cash equivalents	182	195	134	162	1 137
Total current assets	**578**	**660**	**586**	**624**	**1 606**
Assets classified as held for sale	217	534	228	310	-
Total assets	**2 968**	**3 263**	**2 953**	**2 818**	**3 769**

LIABILITIES					
Current loans and other borrowings	21	16	16	126	427
Current derivative financial instruments	-	-	-	-	3
Current trade and other payables	707	709	748	769	839
Current provisions	12	1	3	1	15
Current tax payable	120	54	47	47	85
Total current liabilities	**860**	**780**	**814**	**943**	**1 369**
Loans and other borrowings	670	1 242	1 269	1 569	1 239
Derivative and financial instruments	39	19	11		
Retirement benefit obligations	188	187	184	146	129
Trade and other payables	497	563	574	627	578
Provisions	2	1	-	9	-
Deferred tax liabilities	97	93	175	147	135
Total non-current liabilities	**1 493**	**2 105**	**2 213**	**2 498**	**2 081**
Liabilities classified as held for sale	60	61	-	94	-
Total liabilities	**2 413**	**2 946**	**3 027**	**3 535**	**3 450**
Net assets/(liabilities)	555	317	-74	-717	319
EQUITY					
Equity share capital	162	179	189	178	169
Capital redemption reserve	10	11	12	12	11
Shares held by employee share trusts	-27	-48	-38	-35	-18
Other reserves	-2 893	-2 901	-2 906	-2 896	-2 888
Unrealised gains and losses reserve	71	72	100	111	113
Currency translation reserve	189	214	227	269	269
Retained earnings	3 035	2 781	2 334	1 636	2 653
IHG shareholders' equity	**547**	**308**	**-82**	**-725**	**309**
Non-controlling interest	8	9	8	8	10
Total equity	**555**	**317**	**-74**	**-717**	**319**
Total liabilities and equity	**2 968**	**3 263**	**2 953**	**2 818**	**3 769**

International Hotel Group Analytical Income Statement

USDm	2011	2012	2013	2014	2015
OPERATIONS					
Sales revenue	**1 768,0**	**1 835,0**	**1 903,0**	**1 858,0**	**1 803,0**
Income from associates	1,0	3,0	2,0	-4,0	-3,0
Total operating revenue	**1 769,0**	**1 838,0**	**1 905,0**	**1 854,0**	**1 800,0**
Operating expenses	-771,0	-772,0	-784,0	-741,0	-640,0
Administrative expenses	-361,0	-372,0	-374,0	-382,0	-395,0
Other expenses	10,0	5,0	6,0	16,0	11,0
EBITDA	**647,0**	**699,0**	**753,0**	**747,0**	**776,0**
Depreciation and amortisation	-99,0	-94,0	-85,0	-96,0	-96,0
Impairment charges	-	-	-	-	-
Restructuring and other special operating charges	-	-	-	-	-
EBIT	**548,0**	**605,0**	**668,0**	**651,0**	**680,0**
Tax on EBIT	-133,1	-164,0	-191,8	-195,8	-197,4
NOPAT	**414,9**	**441,0**	**476,2**	**455,2**	**482,6**
FINANCIALS					
Interest expense	-64,0	-57,0	-78,0	-83,0	-92,0
Interest income	2,0	3,0	5,0	3,0	5,0
Net financial expense before special financial items	**-62,0**	**-54,0**	**-73,0**	**-80,0**	**-87,0**
Loss on early extinguishment of debt, net	-	-	-	-	-
Loss on sale of shares and tangible fixed assets	-	-	-	-	-
Net financial expense before tax	**-62,0**	**-54,0**	**-73,0**	**-80,0**	**-87,0**
Tax on net financial expense (tax shield)	16,1	13,0	16,8	16,8	17,4
Net financial expense after tax	**-45,9**	**-41,0**	**-56,2**	**-63,2**	**-69,6**
Net profit for the year	**369,0**	**400,0**	**420,0**	**392,0**	**413,0**
TAX ADJUSTMENTS					
Statutory tax rate (United Kingdom)	26,0%	24,0%	23,0%	21,0%	20,0%
Reported tax	-117,0	-151,0	-175,0	-179,0	-180,0
Tax shield	16,1	13,0	16,8	16,8	17,4
Tax on EBIT	**-133,1**	**-164,0**	**-191,8**	**-195,8**	**-197,4**
Reported net profit	369,0	400,0	420,0	392,0	413,0

International Hotel Group Analytical Balance Sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Non-current assets					
Property, plant and equipment	1 362,0	1 056,0	1 169,0	741,0	428,0
Goodwill and other intangible assets	400,0	447,0	518,0	643,0	1 226,0
Investment in associates and joint ventures	87,0	84,0	85,0	116,0	136,0
Trade and other receivables	-	-	-	3,0	3,0
Non-current tax receivable	41,0	24,0	16,0	34,0	37,0
Deferred tax assets	106,0	204,0	108,0	87,0	49,0
Total non-current operating assets	**1 996,0**	**1 815,0**	**1 896,0**	**1 624,0**	**1 879,0**
Current assets					
Inventories	4,0	4,0	4,0	3,0	3,0
Current trade and other receivables	369,0	422,0	423,0	448,0	462,0
Current tax receivable	20,0	31,0	12,0	4,0	4,0
Total current operating assets	**393,0**	**457,0**	**439,0**	**455,0**	**469,0**
Non-current liabilities					
Trade and other payables	497,0	563,0	574,0	627,0	578,0
Provisions	2,0	1,0	-	9,0	-
Deferred tax liabilities	97,0	93,0	175,0	147,0	135,0
Total non-current operating liabilities	**596,0**	**657,0**	**749,0**	**783,0**	**713,0**
Current liabilities					
Current trade and other payables	707,0	709,0	748,0	769,0	839,0
Current provisions	12,0	1,0	3,0	1,0	15,0
Current tax payable	120,0	54	47	47,0	85,0
Total current operating liabilities	**839,0**	**764,0**	**798,0**	**817,0**	**939,0**
Total non-interest bearing debt (operating liabilities)	**1 435,0**	**1 421,0**	**1 547,0**	**1 600,0**	**1 652,0**
Operating working capital	**-446,0**	**-307,0**	**-359,0**	**-362,0**	**-470,0**
Net operating assets (invested capital)	**954,0**	**851,0**	**788,0**	**479,0**	**696,0**
FINANCIALS					
Equity					
Equity share capital	162,0	179,0	189,0	178,0	169,0
Capital redemption reserve	10,0	11,0	12,0	12,0	11,0
Shares held by employee share trusts	-27,0	-48,0	-38,0	-35,0	-18,0
Other reserves	-2 893,0	-2 901,0	-2 906,0	-2 896,0	-2 888,0
Unrealised gains and losses reserve	71,0	72,0	100,0	111,0	113,0
Currency translation reserve	189,0	214,0	227,0	269,0	269,0
Retained earnings	3 035,0	2 781,0	2 334,0	1 636,0	2 653,0
Non-controlling interest	8,0	9,0	8,0	8,0	10,0
Total equity	**555,0**	**317,0**	**-74,0**	**-717,0**	**319,0**
Interest-bearing debt					
Current loans and other borrowings	21,0	16,0	16,0	126,0	427,0
Current derivative financial instruments	-	-	-	-	3,0
Loans and other borrowings	670,0	1 242,0	1 269,0	1 569,0	1 239,0
Derivative and financial instruments	39,0	19,0	11,0	-	-
Retirement benefit obligations	188,0	187,0	184,0	146,0	129,0
Liabilities classified as held for sale	60,0	61,0	-	94,0	-
Total interest-bearing debt	**978,0**	**1 525,0**	**1 480,0**	**1 935,0**	**1 798,0**
Interest-bearing assets					
Other financial assets	156,0	155,0	236,0	252,0	284,0
Retirement benefit assets	21,0	99,0	7,0	8,0	0,0
Derivative financial instruments	3,0	2,0	1,0	2,0	-
Other financial assets	-	6,0	12,0	5,0	-
Cash and cash equivalents	182,0	195,0	134,0	162,0	1 137,0
Assets classified as held for sale	217,0	534,0	228,0	310,0	-
Total interest-bearing assets	**579,0**	**991,0**	**618,0**	**739,0**	**1 421,0**
Net-interest bearing debt	**399,0**	**534,0**	**862,0**	**1 196,0**	**377,0**
Net financial assets (invested capital)	**954,0**	**851,0**	**788,0**	**479,0**	**696,0**

Appendix D. Starwood Reported & Analytical Financial Statements

Starwood reported income statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
Revenues					
Owned, leased and consolidated joint venture hotels	1 768	1 698	1 612	1 541	1 293
Vacation ownership and residential sales and services	703	1 287	924	674	687
Management fees, franchise fees and other income	814	888	965	1 057	1 047
Other revenues from managed and franchised properties (a)	2 339	2 448	2 614	2 711	2 736
Total consolidated revenues	**5 624**	**6 321**	**6 115**	**5 983**	**5 763**
Costs and Expenses					
Owned, leased and consolidated joint venture hotels	-1 449	-1 391	-1 292	-1 211	-1 005
Vacation ownership and residential	-521	-961	-632	-497	-514
Total 2 (to be hidden, only for vlookup)	-1 970	-2 352	-1 924	-1 708	-1 519
Selling, general, administrative and other	-352	-370	-384	-402	-388
Restructuring and other special charges (credits)	-68	12	-1	4	-100
Depreciation	-235	-226	-239	-254	-251
Amortization	-30	-25	-28	-29	-29
Total 6 (to be hidden, only for vlookup)	-265	-251	-267	-283	-280
Other expenses from managed and franchised properties (a)	-2 339	-2 448	-2 614	-2 711	-2 736
Total consolidated costs and expenses	**4 994**	**5 409**	**519**	**51**	**5 023**
Operating income	**630**	**912**	**925**	**883**	**740**
Equity earnings and gains from unconsolidated ventures, net	11	25	26	27	41
Interest income	3	1	3	3	5
Interest expense	-203	-171	-103	-97	-116
Interest expense, net of interest income	-200	-170	-100	-94	-111
Loss on early extinguishment of debt, net	-16	-128	-	-1	-
Gain (loss) on asset dispositions and impairments, net	0	-21	-23	-33	-1
Income from continuing operations before taxes and noncontrolling interests	**425**	**618**	**828**	**782**	**669**
Income tax expense	75	-148	-263	-139	-180
Income from continuing operations	**500**	**470**	**565**	**643**	**489**
Loss on dispositions, net of tax	-13	92	70	-10	0
Net income	**487**	**562**	**635**	**633**	**489**

Starwood reported balance sheet					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
ASSSETS					
Cash and cash equivalents	454	305	616	935	1 048
Restricted cash	232	158	134	84	54
Accounts receivable, net	569	586	643	661	690
Inventories	812	361	217	236	319
Current securitized vacation ownership notes receivable, net	64	65	54	47	32
Current deferred income taxes	278	290	211	199	-
Prepaid expenses and other	125	124	121	159	152
Total current assets	**2 534**	**1 889**	**1 996**	**2 321**	**2 295**
Investments	259	260	251	214	183
Plant, property and equipment, net	3 232	3 162	3 034	2 634	2 144
Asset held for sale, net	42	36	-	-	-
Goodwill and intangible assets, net	2 053	2 025	2 032	1 956	1 908
Deferred income taxes	639	660	591	596	747
Other assets	355	385	543	711	850
Securitized vacation ownership notes receivable, net	446	438	315	227	141
Total non-current assets	**7 026**	**6 966**	**6 766**	**6 338**	**5 973**
Total assets	**9 560**	**8 855**	**8 762**	**8 659**	**8 268**
LIABILITIES					
Short-term borrowings and current maturities of long-term debt	3	2	2	297	33
Accounts payable	144	121	105	101	98
Current maturities of long-term securitized vacation ownership debt	130	150	97	73	48
Accrued expenses	1 177	1 074	1 092	1 307	1 354
Accrued salaries, wages and benefits	375	395	404	416	400
Accrued taxes and other	163	274	224	256	303
Total current liabilities	**1 992**	**2 016**	**1 924**	**2 450**	**2 236**
Long-term debt	2 194	1 273	1 265	2 398	2 154
Long-term securitized vacation ownership debt	402	383	258	176	124
Deferred income taxes	46	85	48	38	34
Other liabilities	1 971	1 956	1 904	2 069	2 421
Total non-current liabilities	**4 613**	**3 697**	**3 475**	**4 681**	**4 733**
Total liabilities	**6 605**	**5 713**	**5 399**	**7 131**	**6 969**
EQUITY					
Common stock	2	2	2	2	2
Additional paid-in capital	963	816	661	47	115
Accumulated other comprehensive loss	-348	-338	-335	-508	-668
Retained earnings	2 337	2 657	3 032	1 984	1 847
Total Starwood stockholders' equity	**2 954**	**3 137**	**3 360**	**1 525**	**1 296**
Noncontrolling interests	1	5	3	3	3
Total equity	**2 955**	**3 142**	**3 363**	**1 528**	**1 299**
Total liabilities and equity	**9 560**	**8 855**	**8 762**	**8 659**	**8 268**

Starwood Analytical Income Statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Sales revenue	**5 624,0**	**6 321,0**	**6 115,0**	**5 983,0**	**5 763,0**
Income from associates	11,0	25,0	26,0	27,0	41,0
Total operating revenue	**5 635,0**	**6 346,0**	**6 141,0**	**6 010,0**	**5 804,0**
Operating expenses	-1 970,0	-2 352,0	-1 924,0	-1 708,0	-1 519,0
Administrative expenses	-352,0	-370,0	-384,0	-402,0	-388,0
Other expenses	-2 339,0	-2 448,0	-2 614,0	-2 711,0	-2 736,0
EBITDA	**974,0**	**1 176,0**	**1 219,0**	**1 189,0**	**1 161,0**
Depreciation and amortisation	-265,0	-251,0	-267,0	-283,0	-280,0
Impairment charges	-	-21	-23	-33	-1
Restructuring and other special operating charges	-68	12	-1	4	-100
EBIT	**641,0**	**916,0**	**928,0**	**877,0**	**780,0**
Tax on EBIT	-5,0	-216,0	-303,0	-176,6	-224,4
NOPAT	**636,0**	**700,0**	**625,0**	**700,4**	**555,6**
FINANCIALS					
Interest expense	-203,0	-171,0	-103,0	-97,0	-116,0
Interest income	3,0	1,0	3,0	3,0	5,0
Net financial expense before special financial items	**-200,0**	**-170,0**	**-100,0**	**-94,0**	**-111,0**
Loss on early extinguishment of debt, net	-16	-128	-	-1	-
Loss on sale of shares and tangible fixed assets	-13	92	70	-10	-
Net financial expense before tax	**-229,0**	**-206,0**	**-30,0**	**-105,0**	**-111,0**
Tax on net financial expense (tax shield)	80,0	68,0	40,0	37,6	44,4
Net financial expense after tax	**-149,0**	**-138,0**	**10,0**	**-67,4**	**-66,6**
Net profit for the year	**487,0**	**562,0**	**635,0**	**633,0**	**489,0**
TAX ADJUSTMENTS					
Statutory tax rate (Sweden)	40,0%	40,0%	40,0%	40,0%	40,0%
Reported tax	75,0	-148,0	-263,0	-139,0	-180,0
Tax shield	80,0	68,0	40,0	37,6	44,4
Tax on EBIT	**-5,0**	**-216,0**	**-303,0**	**-176,6**	**-224,4**
Reported net profit	487,0	562,0	635,0	633,0	489,0

Starwood Analytical Balance Sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Non-current assets					
Plant, property and equipment, net	3 232,0	3 162,0	3 034,0	2 634,0	2 144,0
Goodwill and intangible assets, net	2 053,0	2 025,0	2 032,0	1 956,0	1 908,0
Deferred income taxes	639,0	660,0	591,0	596,0	747,0
Other assets	355,0	385,0	543,0	711,0	850,0
Total non-current operating assets	**6 279,0**	**6 232,0**	**6 200,0**	**5 897,0**	**5 649,0**
Current assets					
Accounts receivable, net	569,0	586,0	643,0	661,0	690,0
Inventories	812,0	361,0	217,0	236,0	319,0
Current deferred income taxes	278,0	290,0	211,0	199,0	0,0
Prepaid expenses and other	125,0	124,0	121,0	159,0	152,0
Total current operating assets	**1 784,0**	**1 361,0**	**1 192,0**	**1 255,0**	**1 161,0**
Non-interest bearing debt (operating liabilities)					
Accounts payable	144,0	121,0	105,0	101,0	98,0
Accrued expenses	1 177,0	1 074,0	1 092,0	1 307,0	1 354,0
Accrued taxes and other	163,0	274,0	224,0	256,0	303,0
Total current operating liabilities	**1 484,0**	**1 469,0**	**1 421,0**	**1 664,0**	**1 755,0**
Deferred income taxes	46,0	85,0	48,0	38,0	34,0
Other liabilities	1 971,0	1 956,0	1 904,0	2 069,0	2 421,0
Total non-current operating liabilities	**2 017,0**	**2 041,0**	**1 952,0**	**2 107,0**	**2 455,0**
Total non-interest bearing debt (operating liabilities)	**3 501,0**	**3 510,0**	**3 373,0**	**3 771,0**	**4 210,0**
Operating working capital	**300,0**	**-108,0**	**-229,0**	**-409,0**	**-594,0**
Net operating assets (invested capital)	**4 562,0**	**4 083,0**	**4 019,0**	**3 381,0**	**2 600,0**

FINANCIALS					
Equity					
Common stock	2,0	2,0	2,0	2,0	2,0
Additional paid-in capital	963,0	816,0	661,0	47,0	115,0
Accumulated other comprehensive loss	-348,0	-338,0	-335,0	-508,0	-668,0
Retained earnings	2 337,0	2 657,0	3 032,0	1 984,0	1 847,0
Noncontrolling interests	1,0	5,0	3,0	3,0	3,0
Total equity	**2 955,0**	**3 142,0**	**3 363,0**	**1 528,0**	**1 299,0**
Interest-bearing debt					
Short-term borrowings and current maturities of long-term debt	3,0	2,0	2,0	297,0	33,0
Current maturities of long-term securitized vacation ownership debt	130,0	150,0	97,0	73,0	48,0
Long-term debt	2 194,0	1 273,0	1 265,0	2 398,0	2 154,0
Accrued salaries, wages and benefits	375,0	395,0	404,0	416,0	400,0
Long-term securitized vacation ownership debt	402,0	383,0	258,0	176,0	124,0
Total interest-bearing debt	**3 104,0**	**2 203,0**	**2 026,0**	**3 360,0**	**2 759,0**
Interest-bearing assets					
Cash and cash equivalents	454,0	305,0	616,0	935,0	1 048,0
Restricted cash	232,0	158,0	134,0	84,0	54,0
Current securitized vacation ownership notes receivable, net	64,0	65,0	54,0	47,0	32,0
Investments	259,0	260,0	251,0	214,0	183,0
Asset held for sale, net	42,0	36,0	-	-	-
Securitized vacation ownership notes receivable, net	446,0	438,0	315,0	227,0	141,0
Total interest-bearing assets	**1 497,0**	**1 262,0**	**1 370,0**	**1 507,0**	**1 458,0**
Net-interest bearing debt	**1 607,0**	**941,0**	**656,0**	**1 853,0**	**1 301,0**
Net financial assets (invested capital)	**4 562,0**	**4 083,0**	**4 019,0**	**3 381,0**	**2 600,0**

Appendix E. Hilton Reported & Analytical Financial Statements

Hilton reported income statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
Revenues					
Owned and leased hotels	3 898	3 979	4 046	4 239	4 233
Management and franchise fees and other	1 014	1 088	1 175	1 401	1 601
Timeshare	944	1 085	1 109	1 171	1 308
Total sales and service revenue	**5 856**	**6 152**	**6 330**	**6 811**	**7 142**
Other revenues from managed and franchised properties	2 927	3 124	3 405	3 691	4 130
Total revenues	**8 783**	**9 276**	**9 735**	**10 502**	**11 272**
Expenses					
Owned and leased hotels	-3 213	-3 230	-3 147	-3 252	-3 168
Timeshare	-668	-758	-730	-767	-897
Total 2	-3 881	-3 988	-3 877	-4 019	-4 065
Depreciation and amortization	-564	-550	-603	-628	-692
Impairment loss	-20	-54	-	-	-9
General, administrative and other	-416	-460	-748	-491	-611
	-4 881	**-5 052**	**-5 228**	**-5 138**	**-5 377**
Other expenses from managed and franchised properties	-2 927	-3 124	-3 405	-3 691	-4 130
Total expenses	**-7 808**	**-8 176**	**-8 633**	**-8 829**	**-9 507**
Gain on sales of assets, net	-	-	-	-	306
Operating income	**975**	**1 100**	**1 102**	**1 673**	**2 071**
Interest income	11	15	9	10	19
Interest expense	-643	-569	-620	-618	-575
Equity in earnings from unconsolidated affiliates	-145	-11	16	19	23
Gain (loss) on foreign currency transactions	-21	23	-45	26	-41
Gain on debt extinguishment	-	-	229	-	-
Other gain (loss), net	19	15	7	37	-1
Total 8	-2	38	-38	63	-42
Income before income taxes	**196**	**573**	**698**	**1 147**	**1 496**
Income tax benefit (expense)	59	-214	-238	-465	-80
Net income	**255**	**359**	**460**	**682**	**1 416**

Hilton reported balance sheet					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
ASSETS					
Cash and cash equivalents	781	755	594	566	609
Restricted cash and cash equivalents	658	550	266	202	247
Accounts receivable, net	638	719	731	844	876
Inventories	552	415	396	404	442
Current portion of financing receivables, net	103	119	94	66	74
Current portion of securitized financing receivables, net	-	-	27	62	55
Prepaid expenses	136	153	148	133	147
Income taxes receivable	74	76	23	132	97
Other	91	40	104	90	38
Total current assets	**3 033**	**2 827**	**2 383**	**2 499**	**2 585**
Property and equipment, net	9 117	9 197	9 058	7 483	9 119
Property and equipment, net held for sale	-	-	-	1 543	-
Financing receivables, net	770	815	635	416	592
Securitized financing receivables, net	-	-	194	406	295
Investments in affiliates	334	291	260	170	138
Goodwill	6 175	6 197	6 220	6 154	5 887
Brands	-	5 029	5 013	4 963	4 919
Management and franchise contracts, net	-	1 600	1 452	1 306	1 149
Other intangible assets, net	-	744	751	674	586
Deferred income tax assets	-	104	193	155	78
Other intangible assets, net	7 476	-	-	-	-
Other	407	262	403	356	368
Total non-current assets	**24 279**	**24 239**	**24 179**	**23 626**	**23 131**
Total assets	**27 312**	**27 066**	**26 562**	**26 125**	**25 716**
LIABILITIES					
Accounts payable, accrued expenses and other	1 806	1 922	2 079	2 099	2 206
Current maturities of long-term debt	384	392	4	10	111
Current maturities of non-recourse debt	-	15	48	127	117
Income taxes payable	17	20	11	21	33
Total current liabilities	**2 207**	**2 349**	**2 142**	**2 257**	**2 467**
Long-term debt	16 408	15 183	11 751	10 803	9 710
Non-recourse debt	-	405	920	752	609
Deferred revenues	5 006	82	674	495	283
Deferred income tax liabilities	-	4 948	5 053	5 216	4 630
Liability for guest loyalty program	-	503	597	720	784
Other	1 989	1 441	1 149	1 168	1 282
Total non-current liabilities	**23 403**	**22 562**	**20 144**	**19 154**	**17 298**
Total liabilities	**25 610**	**24 911**	**22 286**	**21 411**	**19 765**
EQUITY					
Preferred stock	-	-	-	-	-
Common stock	1	1	10	10	10
Additional paid-in capital	8 454	8 452	9 948	10 028	10 151
Accumulated deficit	-6 098	-5 746	-5 331	-4 658	-3 392
Accumulated other comprehensive loss	-489	-406	-264	-628	-784
Total Hilton stockholders' equity	**1 868**	**2 301**	**4 363**	**4 752**	**5 985**
Noncontrolling interests	-166	-146	-87	-38	-34
Total equity	**1 702**	**2 155**	**4 276**	**4 714**	**5 951**
Total liabilities and equity	**27 312**	**27 066**	**26 562**	**26 125**	**25 716**

Hilton Analytical Income Statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Sales revenue	**8,783.0**	**9,276.0**	**9,735.0**	**10,502.0**	**11,272.0**
Income from associates	-145.0	-11.0	16.0	19.0	23.0
Total operating revenue	**8,638.0**	**9,265.0**	**9,751.0**	**10,521.0**	**11,295.0**
Operating expenses	-3,881.0	-3,988.0	-3,877.0	-4,019.0	-4,065.0
Administrative expenses	-416.0	-460.0	-748.0	-491.0	-611.0
Other expenses	-2,927.0	-3,124.0	-3,405.0	-3,691.0	-4,130.0
EBITDA	**1,414.0**	**1,693.0**	**1,721.0**	**2,320.0**	**2,489.0**
Depreciation and amortisation	-564.0	-550.0	-603.0	-628.0	-692.0
Impairment charges	-20	-54	-	-	-9
Restructuring and other special operating charges	-2	38	-38	63	-42
EBIT	**828.0**	**1,127.0**	**1,080.0**	**1,755.0**	**1,746.0**
Tax on EBIT	-193.8	-435.6	-482.4	-708.2	-302.4
NOPAT	**634.2**	**691.4**	**597.6**	**1,046.8**	**1,443.6**
FINANCIALS					
Interest expense	-643.0	-569.0	-620.0	-618.0	-575.0
Interest income	11.0	15.0	9.0	10.0	19.0
Net financial expense before special financial items	**-632.0**	**-554.0**	**-611.0**	**-608.0**	**-556.0**
Loss on early extinguishment of debt, net	-	-	229	-	-
Loss on sale of shares and tangible fixed assets	-	-	-	-	306
Net financial expense before tax	**-632.0**	**-554.0**	**-382.0**	**-608.0**	**-250.0**
Tax on net financial expense (tax shield)	252.8	221.6	244.4	243.2	222.4
Net financial expense after tax	**-379.2**	**-332.4**	**-137.6**	**-364.8**	**-27.6**
Net profit for the year	**255.0**	**359.0**	**460.0**	**682.0**	**1,416.0**
TAX ADJUSTMENTS					
Statutory tax rate (United States)	40.0%	40.0%	40.0%	40.0%	40.0%
Reported tax	59.0	-214.0	-238.0	-465.0	-80.0
Tax shield	252.8	221.6	244.4	243.2	222.4
Tax on EBIT	**-193.8**	**-435.6**	**-482.4**	**-708.2**	**-302.4**
Reported net profit	255.0	359.0	460.0	682.0	1,416.0

Hilton Analytical Balance Sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Non-current assets					
Property and equipment, net	9,117.0	9,197.0	9,058.0	7,483.0	9,119.0
Investments in affiliates	334.0	291.0	260.0	170.0	138.0
Goodwill	6,175.0	6,197.0	6,220.0	6,154.0	5,887.0
Brands	-	5,029.0	5,013.0	4,963.0	4,919.0
Management and franchise contracts, net	-	1,600.0	1,452.0	1,306.0	1,149.0
Other intangible assets, net	-	744.0	751.0	674.0	586.0
Deferred income tax assets	-	104.0	193.0	155.0	78.0
Other intangible assets, net	7,476.0	-	-	-	-
Other	407.0	262.0	403.0	356.0	368.0
Total non-current operating assets	**23,509.0**	**23,424.0**	**23,350.0**	**21,261.0**	**22,244.0**
Current assets					
Accounts receivable, net	638.0	719.0	731.0	844.0	876.0
Inventories	552.0	415.0	396.0	404.0	442.0
Prepaid expenses	136.0	153.0	148.0	133.0	147.0
Income taxes receivable	74.0	76.0	23.0	132.0	97.0
Other	91.0	40.0	104.0	90.0	38.0
Total current operating assets	**1,491.0**	**1,403.0**	**1,402.0**	**1,603.0**	**1,600.0**
Non-interest bearing debt (operating liabilities)					
Accounts payable, accrued expenses and other	1,584.0	1,662.0	1,955.0	1,902.0	1,969.0
Income taxes payable	17.0	20.0	11.0	21.0	33.0
Total current operating liabilities	**1,601.0**	**1,682.0**	**1,966.0**	**1,923.0**	**2,002.0**
Deferred revenues	5,006.0	82.0	674.0	495.0	283.0
Deferred income tax liabilities	-	4,948.0	5,053.0	5,216.0	4,630.0
Liability for guest loyalty program	-	503.0	597.0	720.0	784.0
Other	1989	1441	1149	1168	1282
Total non-current operating liabilities	**6,995.0**	**6,974.0**	**7,473.0**	**7,599.0**	**6,979.0**
Total non-interest bearing debt (operating liabilities)	**8,596.0**	**8,656.0**	**9,439.0**	**9,522.0**	**8,981.0**
Operating working capital	**-110.0**	**-279.0**	**-564.0**	**-320.0**	**-402.0**
Net operating assets (invested capital)	**16,404.0**	**16,171.0**	**15,313.0**	**13,342.0**	**14,863.0**
FINANCIALS					
Equity					
Preferred stock	-	-	-	-	-
Common stock	1.0	1.0	10.0	10.0	10.0
Additional paid-in capital	8,454.0	8,452.0	9,948.0	10,028.0	10,151.0
Accumulated deficit	-6,098.0	-5,746.0	-5,331.0	-4,658.0	-3,392.0
Accumulated other comprehensive loss	-489.0	-406.0	-264.0	-628.0	-784.0
Noncontrolling interests	-166.0	-146.0	-87.0	-38.0	-34.0
Total equity	**1,702.0**	**2,155.0**	**4,276.0**	**4,714.0**	**5,951.0**
Interest-bearing debt					
Current maturities of long-term debt	384.0	392.0	4.0	10.0	111.0
Current maturities of non-recourse debt	-	15.0	48.0	127.0	117.0
Long-term debt	16,408.0	15,183.0	11,751.0	10,803.0	9,710.0
Benefit obligations	222.0	260.0	124.0	197.0	237.0
Non-recourse debt	-	405.0	920.0	752.0	609.0
Total interest-bearing debt	**17,014.0**	**16,255.0**	**12,847.0**	**11,889.0**	**10,784.0**
Interest-bearing assets					
Cash and cash equivalents	781.0	755.0	594.0	566.0	609.0
Restricted cash and cash equivalents	658.0	550.0	266.0	202.0	247.0
Current portion of financing receivables, net	103.0	119.0	94.0	66.0	74.0
Current portion of securitized financing receivables, net	-	-	27.0	62.0	55.0
Property and equipment, net held for sale	-	-	0.0	1,543.0	0.0
Financing receivables, net	770.0	815.0	635.0	416.0	592.0
Securitized financing receivables, net	-	-	194.0	406.0	295.0
Total interest-bearing assets	**2,312.0**	**2,239.0**	**1,810.0**	**3,261.0**	**1,872.0**
Net-interest bearing debt	**14,702.0**	**14,016.0**	**11,037.0**	**8,628.0**	**8,912.0**
Net financial assets (invested capital)	**16,404.0**	**16,171.0**	**15,313.0**	**13,342.0**	**14,863.0**

Appendix F. Marriott Reported & Analytical Financial Statements

Marriott reported income statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
Revenues					
Base management fees	602	581	621	672	698
Franchise fees	506	607	666	745	853
Incentive management fees	195	232	256	302	319
Owned, leased, and other revenue	1 083	989	950	1 022	986
Timeshare sales and services	1 088	-	-	-	-
Cost reimbursements	8 843	9 405	10 291	11 055	11 630
Total Revenues	**12 317**	**11 814**	**12 784**	**13 796**	**14 486**
Operating costs and expenses					
Owned, leased, and other - direct	-943	-824	-779	-775	-733
Timeshare - direct	-929	-	-	-	-
Timeshare strategy - impairment charges	-324	-	-	-	-
Reimbursed costs	-8 843	-9 405	-10 291	-11 055	-11 630
Total 2	-10 715	-10 229	-11 070	-11 830	-12 363
Depreciation, amortization, and other	-	-	-	-148	-139
General, administrative, and other	-752	-645	-726	-659	-634
Total operating cost and expenses	**-11 791**	**-10 874**	**-11 796**	**-12 637**	**-13 136**
Operating income	**526**	**940**	**988**	**1 159**	**1 350**
Gains and other income, net	-7	42	11	8	27
Interest expense	-164	-137	-120	-115	-167
Interest income	14	17	23	30	29
Equity in earnings	-13	-13	-5	6	16
Income before income taxes	**356**	**849**	**897**	**1 088**	**1 255**
Provision for income taxes	-158	-278	-271	-335	-396
Net income	**198**	**571**	**626**	**753**	**859**

Marriott reported balance sheet					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
ASSETS					
Cash and equivalents	102	88	126	104	96
Accounts and notes receivable, net	875	1 028	1 081	1 100	1 103
Inventory	11	-	-	-	-
Current deferred taxes, net	282	280	252	-	-
Prepaid expenses	54	57	67	64	77
Other	-	22	27	109	30
Assets held for sale	-	-	350	233	78
Total current assets	**1 324**	**1 475**	**1 903**	**1 610**	**1 384**
Property and equipment, net	1 168	1 539	1 543	1 460	1 029
Contract acquisition costs and other	846	1 115	1 131	1 351	1 451
Goodwill	875	874	874	894	943
Equity and cost method investments	265	216	222	224	165
Notes receivable, net	298	180	142	215	215
Deferred taxes, net	873	676	647	819	672
Other noncurrent assets	261	267	332	260	223
Total non-current assets	**4 586**	**4 867**	**4 891**	**5 223**	**4 698**
Total assets	**5 910**	**6 342**	**6 794**	**6 833**	**6 082**
LIABILITIES					
Current portion of long-term debt	355	407	6	324	300
Accounts payable	548	569	557	605	593
Accrued payroll and benefits	650	745	817	799	861
Liability for guest loyalty programs	514	593	666	677	952
Accrued expenses and other	491	459	629	633	527
Total current liabilities	**2 558**	**2 773**	**2 675**	**3 038**	**3 233**
Long-term debt	1 816	2 528	3 147	3 447	3 807
Liability for guest loyalty programs	1 434	1 428	1 475	1 657	1 622
Other noncurrent liabilities	883	898	912	891	1 010
Total non-current liabilities	**4 133**	**4 854**	**5 534**	**5 995**	**6 439**
Total liabilities	**6 691**	**7 627**	**8 209**	**9 033**	**9 672**
EQUITY					
Class A Common Stock	5	5	5	5	5
Additional paid-in-capital	2 513	2 585	2 716	2 802	2 821
Retained earnings	3 212	3 509	3 837	4 286	4 878
Treasury stock, at cost	-6 463	-7 340	-7 929	-9 223	-11 098
Accumulated other comprehensive loss	-48	-44	-44	-70	-196
Total equity	**-781**	**-1 285**	**-1 415**	**-2 200**	**-3 590**
Total liabilities and equity	**5 910**	**6 342**	**6 794**	**6 833**	**6 082**

Marriott Analytical Income Statement					
USDm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Sales revenue	**12 317,0**	**11 814,0**	**12 784,0**	**13 796,0**	**14 486,0**
Income from associates	-13,0	-13,0	-5,0	6,0	16,0
Total operating revenue	**12 304,0**	**11 801,0**	**12 779,0**	**13 802,0**	**14 502,0**
Operating expenses	-10 715,0	-10 229,0	-11 070,0	-11 830,0	-12 363,0
Administrative expenses	-752,0	-645,0	-726,0	-659,0	-634,0
Other expenses	0,0	0,0	0,0	0,0	0,0
EBITDA	**837,0**	**927,0**	**983,0**	**1 313,0**	**1 505,0**
Depreciation and amortisation	-	-	-	-148,0	-139,0
Impairment charges	-324	-	-	-	-
Restructuring and other special operating charges	-7	42	11	8	27
EBIT	**506,0**	**969,0**	**994,0**	**1 173,0**	**1 393,0**
Tax on EBIT	-218,0	-326,0	-309,8	-369,0	-451,2
NOPAT	**288,0**	**643,0**	**684,2**	**804,0**	**941,8**
FINANCIALS					
Interest expense	-164,0	-137,0	-120,0	-115,0	-167,0
Interest income	14,0	17,0	23,0	30,0	29,0
Net financial expense before special financial items	**-150,0**	**-120,0**	**-97,0**	**-85,0**	**-138,0**
Loss on early extinguishment of debt, net	-	-	-	-	-
Loss on sale of shares and tangible fixed assets	-	-	-	-	-
Net financial expense before tax	**-150,0**	**-120,0**	**-97,0**	**-85,0**	**-138,0**
Tax on net financial expense (tax shield)	60,0	48,0	38,8	34,0	55,2
Net financial expense after tax	**-90,0**	**-72,0**	**-58,2**	**-51,0**	**-82,8**
Net profit for the year	**198,0**	**571,0**	**626,0**	**753,0**	**859,0**
TAX ADJUSTMENTS					
Statutory tax rate (United States)	40,0%	40,0%	40,0%	40,0%	40,0%
Reported tax	-158,0	-278,0	-271,0	-335,0	-396,0
Tax shield	60,0	48,0	38,8	34,0	55,2
Tax on EBIT	**-218,0**	**-326,0**	**-309,8**	**-369,0**	**-451,2**
Reported net profit	198,0	571,0	626,0	753,0	859,0

Marriott Analytical Balance Sheet					
EURm	**2011**	**2012**	**2013**	**2014**	**2015**
OPERATIONS					
Non-current assets					
Property and equipment, net	1 168,0	1 539,0	1 543,0	1 460,0	1 029,0
Contract acquisition costs and other	846,0	1 115,0	1 131,0	1 351,0	1 451,0
Goodwill	875,0	874,0	874,0	894,0	943,0
Equity and cost method investments	265,0	216,0	222,0	224,0	165,0
Notes receivable, net	298,0	180,0	142,0	215,0	215,0
Deferred taxes, net	873,0	676,0	647,0	819,0	672,0
Other noncurrent assets	261,0	267,0	332,0	260,0	223,0
Total non-current operating assets	**4 586,0**	**4 867,0**	**4 891,0**	**5 223,0**	**4 698,0**
Current assets					
Accounts and notes receivable, net	875,0	1 028,0	1 081,0	1 100,0	1 103,0
Inventory	11,0	-	-	-	-
Current deferred taxes, net	282,0	280,0	252,0	-	-
Prepaid expenses	54,0	57,0	67,0	64,0	77,0
Other	-	22,0	27,0	109,0	30,0
Total current operating assets	**1 222,0**	**1 387,0**	**1 427,0**	**1 273,0**	**1 210,0**
Non-interest bearing debt (operating liabilities)					
Accounts payable	548,0	569,0	557,0	605,0	593,0
Liability for guest loyalty programs	514,0	593,0	666,0	677,0	952,0
Accrued expenses and other	491,0	459,0	629,0	633,0	527,0
	1 553,0	1 621,0	1 852,0	1 915,0	2 072,0
Liability for guest loyalty programs	1 434,0	1 428,0	1 475,0	1 657,0	1 622,0
Other noncurrent liabilities	883,0	898,0	912,0	891,0	1 010,0
	2 317,0	2 326,0	2 387,0	2 548,0	2 632,0
Total non-interest bearing debt (operating liabilities)	**5 423,0**	**5 568,0**	**6 091,0**	**6 378,0**	**6 776,0**
Operating working capital	**-331,0**	**-234,0**	**-425,0**	**-642,0**	**-862,0**
Net operating assets (invested capital)	**1 938,0**	**2 307,0**	**2 079,0**	**2 033,0**	**1 204,0**

FINANCIALS					
Equity					
Class A Common Stock	5,0	5,0	5,0	5,0	5,0
Additional paid-in-capital	2 513,0	2 585,0	2 716,0	2 802,0	2 821,0
Retained earnings	3 212,0	3 509,0	3 837,0	4 286,0	4 878,0
Treasury stock, at cost	-6 463,0	-7 340,0	-7 929,0	-9 223,0	-11 098,0
Accumulated other comprehensive loss	-48,0	-44,0	-44,0	-70,0	-196,0
Total equity	**-781,0**	**-1 285,0**	**-1 415,0**	**-2 200,0**	**-3 590,(**
Interest-bearing debt					
Current portion of long-term debt	355,0	407,0	6,0	324,0	300,0
Long-term debt	1 816,0	2 528,0	3 147,0	3 447,0	3 807,0
Accrued payroll and benefits	650,0	745,0	817,0	799,0	861,0
Total interest-bearing debt	**2 821,0**	**3 680,0**	**3 970,0**	**4 570,0**	**4 968,(**
Interest-bearing assets					
Cash and equivalents	102,0	88,0	126,0	104,0	96,0
Assets held for sale	-	-	350,0	233,0	78,0
Total interest-bearing assets	**102,0**	**88,0**	**476,0**	**337,0**	**174,0**
Net-interest bearing debt	**2 719,0**	**3 592,0**	**3 494,0**	**4 233,0**	**4 794,(**
Net financial assets (invested capital)	**1 938,0**	**2 307,0**	**2 079,0**	**2 033,0**	**1 204,(**

Appendix G. Business Model

Comparison of Business Models

Peer	**2011**	**2012**	**2013**	**2014**	**2015**
Rezidor					
Franchised as % of total	24%	25%	26%	26%	27%
Managed as % of total	52%	53%	54%	54%	53%
Fee-based share	76%	77%	80%	79%	80%
IHG					
Franchised as % of total	86%	85%	85%	85%	84%
Managed as % of total	14%	14%	15%	15%	16%
Fee-based share	100%	100%	100%	100%	100%
Starwood					
Franchised as % of total	48%	46%	47%	48%	49%
Managed as % of total	46%	48%	48%	48%	47%
Fee-based share	93%	94%	95%	96%	96%
Hilton					
Franchised as % of total	na	na	83%	81%	84%
Managed as % of total	na	na	13%	13%	13%
Fee-based share	na	na	96%	94%	97%
Marriott					
Franchised as % of total	66%	67%	68%	69%	69%
Managed as % of total	28%	27%	26%	26%	20%
Fee-based share	94%	94%	94%	94%	89%

Appendix H. Return in Invested Capital Pre-tax

Return on Invested Capital (Average Values)						
After Tax	**2011**	**2012**	**2013**	**2014**	**2015**	**Average**
Rezidor	-7.5%	-10.9%	16.5%	9.7%	19.8%	**9.3%**
IHG	43.5%	48.9%	58.1%	71.9%	82.1%	**58.1%**
Starwood	13.9%	16.2%	15.4%	18.9%	18.6%	**16.2%**
Hilton	-	4.2%	3.8%	7.3%	10.2%	**6.4%**
Marriott	14.9%	30.3%	31.2%	39.1%	58.2%	**31.2%**
Average	**16.2%**	**17.7%**	**25.0%**	**29.4%**	**37.8%**	**-**

Source: Company annual reports, Own creation

$$ROIC\ (after\ tax) = \frac{NOPAT}{Invested\ Capital}$$

Appendix I. Upside Scenario Revenue, Cost and Free Cash Flow Forecast

Revenue Forecast by Region	Forecast Period				
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Nordics	455	468	480	492	504
Growth	*3.0%*	*3.0%*	*2.5%*	*2.5%*	*2.5%*
Rest of Western Europe	498	508	519	529	540
Growth	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
Eastern Europe	36	38	39	41	43
Growth	*3.0%*	*4.0%*	*4.0%*	*5.0%*	*5.0%*
Middle East, Africa & Others	33	35	36	38	39
Growth	5.0%	5.0%	4.0%	4.0%	4.0%
Total Revenue	**1,023**	**1,049**	**1,074**	**1,100**	**1,126**
Total Revenue Growth	*2.6%*	*2.6%*	*2.4%*	*2.4%*	*2.4%*

Forecasted EBITDA and EBIT	Forecast Period				
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Revenue	**1,023**	**1,049**	**1,074**	**1,100**	**1,126**
Growth	*1.7%*	*1.8%*	*1.5%*	*1.3%*	*1.3%*
Costs of Goods Sold for Food & Drinks and Other	-58	-59	-59	-59	-60
Personnel Cost and Contract Labour	-352	-360	-367	-375	-383
Other Operating Expenses	-246	-251	-256	-261	-266
Insurance of Properties and Property Tax	-16	-16	-16	-16	-16
Rental Expense	-249	-245	-240	-235	-230
Share of Income in Associates and JV's	2	2	2	2	2
EBITDA	**103**	**120**	**138**	**156**	**175**
Margin	*10.1%*	*11.5%*	*12.8%*	*14.2%*	*15.5%*
Depreciation and Amortisation	-36	-37	-37	-38	-39
Write-Downs and Reversal of Write-Downs	-6	-4	-2	0	0
Costs due to Termination/Restructuring of Contracts	-3	-3	-4	-5	-5
EBIT	**59**	**76**	**94**	**113**	**130**
Margin	*5.8%*	*7.3%*	*8.8%*	*10.3%*	*11.6%*

Free Cash Flows	Forecast Period				
EURm	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
EBIT	59	76	94	113	130
Interest Expense	-31	-30	-28	-25	-20
Profit Before Tax	**28**	**47**	**67**	**88**	**110**
Tax Expense	-6	-10	-15	-19	-24
Net Income	**22**	**36**	**52**	**69**	**86**
+ Depreciation and Amortisation	36	37	37	38	39
- Capex	-36	-37	-37	-38	-39
- Change in OWC	1	1	1	1	1
Free Cash Flows	**23**	**38**	**53**	**70**	**87**

Appendix J. Upside Scenario Debt Schedule

Debt Schedule	Forecast Period				
	2016E	**2017E**	**2018E**	**2019E**	**2020E**
Beginning Cash Balance	**20**	**20**	**21**	**21**	**22**
+ Free Cash Flows	23	38	53	70	87
- Minimum Cash Balance	-20	-21	-21	-22	-23
Cash Flows Available for Debt Repayments	**22**	**37**	**53**	**70**	**87**
- Mandatory Debt Repayments (TLA)	-6	-13	-25	-24	0
- Mandatory Debt Repayments (TLB)	-3	-3	-3	-3	-3
Cash Flows Available for Optional Debt Repayments	**13**	**22**	**24**	**43**	**84**
- Optional Debt Repayments (TLA)	-13	-22	-24	0	-
- Optional Debt Repayments (TLB)	-	-	-	-43	-84
- Optional Debt Repayments (Subordinated Debt)	-	-	-	0	0
Cash Flows Available after Debt Repayments	-	-	-	0	0
Ending Cash Balance	**20**	**21**	**21**	**22**	**23**
TLA					
Amortisation Schedule	5%	10%	20%	30%	35%
Interest Rate	4.33%	4.33%	4.33%	4.33%	4.34%
Beginning Balance	**127**	**108**	**74**	**24**	**0**
- Mandatory Debt Repayments (TLA)	-6	-13	-25	-24	0
- Optional Debt Repayments (TLA)	-13	-22	-24	0	-
Ending Balance	**108**	**74**	**24**	**0**	**0**
- Interest Expense	-5	-4	-2	-1	0
TLB					
Amortisation Schedule	1%	1%	1%	1%	1%
Interest Rate	6.00%	6.00%	6.00%	6.00%	6.01%
Beginning Balance	**297**	**294**	**291**	**288**	**243**
- Mandatory Debt Repayments	-3	-3	-3	-3	-3
- Optional Debt Repayments	-	-	-	-43	-84
Ending Balance	**294**	**291**	**288**	**243**	**156**
- Interest Expense	-18	-18	-17	-16	-12
Subordinated Debt					
Amortisation Schedule	-	-	-	-	-
Interest Rate	10.00%	10.00%	10.00%	10.00%	10.00%
Beginning Balance	**81**	**81**	**81**	**81**	**81**
- Optional Debt Repayments	-	-	-	0	0
Ending Balance	**81**	**81**	**81**	**81**	**81**
- Interest Expense	-8	-8	-8	-8	-8
Total Debt Summary					
Beginning Balance	**506**	**483**	**446**	**393**	**324**
- Mandatory Debt Repayments	-9	-16	-28	-27	-3
- Optional Debt Repayments	-13	-22	-24	-43	-84
Total Amortisation	-22	-37	-53	-70	-87
Ending Balance	**483**	**446**	**393**	**324**	**237**
Cash	20	21	21	22	23
Net Debt	**463**	**425**	**372**	**302**	**214**