



InterContinental Hotels Group PLC

Q3 2019 Results

Friday, 18th October 2019

Welcome and Disclaimer

Heather Wood

Group Financial Controller, InterContinental Hotels Group PLC

Good morning everyone and welcome to IHG's 2019 third quarter trading update conference call. I am Heather Wood, Group Financial Controller and I am joined this morning by Paul Edgecliffe-Johnson, our Chief Financial Officer.

As in previous quarters, we will not be holding a separate call for US investors but will be making the replay of this call available on our website. I therefore need to remind you that in the discussions today the company may make certain forward-looking statements as defined under US law.

Please refer to this morning's announcement and the company's SEC filings for factors that could lead actual results to differ materially from those expressed in, or implied by, any such forward-looking statements.

I will now hand the call over to Paul.

Financial Results

Paul Edgecliffe-Johnson

Chief Financial Officer, InterContinental Hotels Group PLC

Thanks Heather and good morning everyone. I will begin with a review of our trading performance before providing you with an update on our strategic initiatives and outlook.

I will start with RevPAR, which for the Group declined 0.8% in the third quarter. Excluding the Hong Kong market, where trading conditions have been challenging, RevPAR was down 0.5% in the quarter and is up 0.1% year to date. In the Americas and the US, RevPAR declined 0.6%.

Through the quarter we observed a meaningful drag on our reported RevPAR from hotels under renovation, as our owners invest heavily behind our brand refresh activity. There is always some impact but when demand is lower this impact is more pronounced; this accounted for some 40 basis points of our US RevPAR decline.

At the same time and as we mentioned at our interim results, we continue to face a headwind from small groups business, which Holiday Inn and Crowne Plaza are over-weighted to and where demand has reduced, with group-driven revenues for those brands down some 3% in the quarter.

Holiday Inn Express, with its different mix of business, grew RevPAR and outperformed the upper-midscale segment. Overall, our RevPAR performance year to date is in line with the segments in which we compete.

Europe, Middle East, Asia & Africa RevPAR was up 0.2%. In the UK, RevPAR was up 1% in the third quarter. London was up 3%, helped by strong international inbound demand, while the provinces were flat. Year to date, we continue to outperform the industry in the UK.

RevPAR in Continental Europe was up 1%. France saw 1% growth, whilst Germany was down 7% due to the lapping of the European Athletics Championships and a number of significant trade fairs last year.

Middle East RevPAR was down 1% with increased supply and continued political unrest in the region, partly offset by the timing of the Hajj pilgrimage. Australia RevPAR declined 1%, held back by oversupply in certain cities and Japan was also down 1%, due to disruption following Typhoon Lekima.

Greater China's RevPAR performance was impacted by ongoing unrest in the Hong Kong market, where RevPAR fell 36% in the quarter, including an over 50% decline in September. This is likely to result in a fee income loss for the second half of approximately \$5 million.

In Mainland China, third quarter RevPAR fell 2%. Uncertainty from the US-China trade negotiations has impacted corporate business demand, but this has been partly offset by ongoing strength in the domestic leisure market. Overall, we continue to outperform the industry.

As a reminder, we are hosting an educational event on our Greater China business on 31st October in London, which will also be webcast.

Moving now to our other key driver of growth, net system size, our focus on accelerating growth delivered strong results, with net system size increasing 4.7% in the third quarter. This is a little below the growth rate we reported at the half-year stage due to the phasing of openings and the particularly strong additions we experienced in the third quarter of 2018. We remain on track, though, for our net system size to increase by over 5% for the full year.

We opened 13,000 rooms and at the same time, we remain focused on removing underperforming hotels from our system and exited 4,000 rooms. We are well placed for future growth, signing 25,000 rooms in the quarter, and 73,000 rooms year to date, taking our pipeline to 289,000 rooms.

In Greater China, we continue to see strong traction for our franchise offer with 20 signings in the quarter, taking our total to more than 200 signings since launch just over three years ago.

Looking now at our brands, in the Mainstream segment, the Holiday Inn Brand Family continues to be the engine of growth for our business. In the third quarter, we signed almost 11,000 Holiday Inn brand family rooms into our pipeline.

Elsewhere in the Mainstream segment, avid continues to attract interest from owners. We have now signed more than 200 hotels since launch two years ago, including 11 in the third quarter. We have three properties open and expect to have around ten open by the end of the year. With nearly 80 hotels with planning approval obtained or ground broken, we expect openings to gain further momentum into 2020.

At the end of the quarter, we also launched franchise sales for our new all-suites brand Atwell Suites and have already received ten franchise applications.

In our Upscale portfolio, demand for voco hotels continues to be strong, with six hotels open across the UK, Australia and the Middle East and a further 17 properties signed since launch last year. We remain on track to sign around 30 hotels by the end of 2019.

We signed seven Crowne Plaza properties in the quarter, bringing the total pipeline to 93 hotels, or 26,000 rooms.

Hotel Indigo continues to gain momentum with the highest ever number of signings in the year to date. We now have deals signed in the pipeline that will take the brand to 17 new countries.

The momentum of high-quality signings across our Luxury portfolio continues to gain pace. We signed five InterContinental Hotels and Resorts in the quarter in iconic locations including Japan and New Caledonia, and three Six Senses resort deals, including a property in the Galápagos Islands, taking the total signed since acquisition of the brand in February this year to seven.

So, to summarise, our year-to-date RevPAR performance was in line with, or ahead of, the industry in our key markets. Net system size growth increased 4.7% in the third quarter and we expect this to further accelerate by the year end to over 5%. We continue to make good progress against the strategic initiatives that underpin our growth ambition to deliver industry-leading net system size growth over the medium term.

Looking ahead, despite the weaker RevPAR environment and challenges in some of our markets, we remain confident in our financial outcome for the rest of the year. This includes the benefit of around \$10 million of non-recurring items identified since the half year, including one significant liquidated damage receipt and a positive IFRS 16 related adjustment on a leased hotel.

We continue to expect net system size to accelerate over the medium term as the key driver of our growth. This, combined with our asset-light, cash generative model, disciplined approach to cost management and ongoing execution against our strategic initiatives, positions us well for the future.

With that, I will open up the call for questions.

Q&A

Vicki Stern (Barclays): Thank you, morning. Yes, three questions, please. Just firstly, coming back to the renovations, you talked about this 40bps drag and you related that to the fact that obviously it is tougher in a tough demand environment. I guess, if the demand environment stays in line with how it is currently, how do we think about that drag persisting? Was it sort of a particularly heavy quarter or should we just think about that 40bps drag as something that might sit for a number of quarters?

The second question: I obviously noted your comments on your ambition to continue to accelerate from current levels. As we look into 2020, are you still expecting that net system growth can actually accelerate in 2020 versus the 2019 metric?

Then, just finally, on fee-based margin growth, just where you – where all this is going to lead to versus the 80–120bps range both for this year and as we look into next year? Thank you.

Paul Edgecliffe-Johnson: Okay, thanks Vicki. And actually I think that I'll take those in reverse order. Yes, no change to what we are thinking about in terms of margin. That is our aspiration for this year and into the medium term.

In terms of system growth, I think that we are being pretty clear that what we are trying to do and have been for some years is make sure that we have the right offers for our owners in our market. So, we have launched the new brands that we have spoken about, with avid now having 200 lined up and 80 either under construction or in final planning, voco and most recently Atwell. That is all going to help us for a really long period of time to continue to grow our net system size growth.

We will probably see a lower benefit from that in 2020 than we will in further out years, so the openings out of those will really start to accelerate but that said, 2020 is again looking to be a good year for system growth. We, as we have talked about before, did get some benefit from the Macau signing that we called out in 2019 but even excluding that in 2020 we would see some underlying growth, I think, in 2019.

In terms of the refurbishment activity, we have called it out in particular because we are always working with our owners to ensure that the quality of our product is absolutely as good as it can be. Owners are investing behind our hotels, particularly the Formula Blue new room product for Holiday Inn Express, and then our Crowne Plaza Accelerate programme, where we are lifting the overall quality of the estate there. However, in a lower-demand environment you can see a little bit more of an impact from that. I suspect our owners will want to continue to invest behind taking their hotels up to even higher levels of quality, so I think we will continue to see. Actually, what impact it has really depends on the demand environment that we see. As we have spoken about before, we have a pretty short booking window, so we do not actually have a great deal of visibility on that but perhaps that is something we will be able to come back and talk about more at the full-year results.

Jamie Rollo (Morgan Stanley): Hi, thanks, morning. Three questions, please, again. First, Paul, just sort of a general comment about the RevPAR environment: is this part of a little synchronised global downturn, do you think, or is it just some sort of one-off political macro issues? If it is part of the former, is there any action you are taking to sort of change the model or to reduce the cost base?

Secondly, on China, it has the highest mix of incentive management fees, I think, in about a third of fee revenue there. So, could that have more of an adverse impact on the bottom line particularly as you go into next year?

Then, finally, I note that your third quarter signings are down quite sharply in the Americas and they did not grow in China. Are there any signs of development or lenders getting cold feet there? Thank you.

Paul Edgecliffe-Johnson: Thanks Jamie. So, look, in terms of the overall RevPAR environment, we did call out in our release that it is a little weaker RevPAR environment and that is held back by the impact of the protests in Hong Kong and in China more broadly by what is going on there with the US-China trade deals. I think in the US we have seen sequentially lower levels of RevPAR across the quarter and with this being our lowest level at 60 basis point reduction, with most of that being from the refurbishment activity. There are two areas we have called out in the US where we are seeing it be a bit more challenging: the small groups bookings, we are seeing a reduction there across Holiday Inn and Crowne Plaza in particular, that is down around 3%.

Then, in terms of sectors, we are seeing the automotive and the manufacturing sectors in the US a little weaker. That is really in line with the overall US economic activity data. Look, I am not going to try and be an economic prognosticator but I can only tell you what we are seeing.

In terms of China and our contracts there, yes, that is where we have the most managed contracts as a proportion of our business. Of course, a lot of the new signings coming through are franchise contracts for the Holiday Inn Express model, so that will change a bit over time. However, the contracts there are a little bit more straightforward, shall we say, than they are in the US, so it typically is just a share of revenues and then a share of gross operating profit out of the hotels. So, although you may see a little bit more operational leverage in the fees, it is not as significant as it can be in other parts of the world.

Then, in terms of the signings, actually I am very pleased with the signings performance. It is almost bang on what we did by this time last year and if we end up, for the full year, with, as we did last year, signing 100,000 rooms, that is going to continue to build very strongly towards our ambition net system size growth. We have a lot of rooms in our pipeline that will open up over the next few years and that is a lot of stored growth. So, although you may have some differences quarter by quarter and region by region, there is an awful lot of growth to come.

Jamie Rollo: Thanks, I was trying to get at, really, on the first point, is there any action you are taking on cost if this is part of more of an underlying slowdown?

Paul Edgecliffe-Johnson: Thanks Jamie. As you will recall a couple of years ago, we did do quite a big corporate restructure to take a lot of cost, if you like, out of our back office and put it into our front office so that we have some more brands to invest behind and investing behind our capabilities: putting two of our business units together and combining our Commercial and our Technology functions. So that has given us a lot to invest and that is being deployed effectively. We are very pleased with what we are seeing from that.

Our focus is on growth. Our focus is on the long term, continuing to invest behind those initiatives which are so important for the long-term health of the business. So there is no current intention that we would be taking money away from those very important strategic initiatives and just taking it down to the profit line.

Jamie Rollo: If I can just follow up with one more, if I may, it sounds like you are happy with consensus around \$860 million including the \$10 million, so \$850 million, which is about 2% growth. How do you feel about consensus expectations for 2020, which I think are sitting at \$915 million, which is up about 8%, again stripping out the \$10 million in 2019.

Paul Edgecliffe-Johnson: In terms of the 2019 financial expectations, we said that we are broadly happy and I have called out the potential impact in Hong Kong through the second half of the protests there, so that is potentially around the \$5 million mark. In terms of 2020, it is a really broad range in terms of expectations there, so it is a little early to comment on that. I would say that if we saw a similar level of disruption in Hong Kong into the first half of 2020, we might see a similar level of impact to profit, so that may well continue over into 2020. However, beyond that, I think it is a little hard to call.

Tim Barrett (Numis): Morning Paul, I have two things, please. Firstly, just going back to your group comment, I totally appreciate you have a short booking window but was the comment on groups in relation to bookings in the quarter for the quarter or are you just trying to flag a bit of groups softness from here onwards?

Then, secondly, I do not know if this is pedantic; it might be a rounding error but the IFRS 16 adjustment, does it have any impact below the EBIT line, please? Thanks a lot.

Paul Edgecliffe-Johnson: Thanks Tim. In terms of the groups in the quarter for the quarter, what I am really just trying to pull out where we are seeing it a little bit more challenging, where the demand is coming off. As to whether those were booked in a short window or a longer window, there is always a mix. Because they are slightly smaller meetings, they are not the sort of very large incentive conferences, for example, that are booked a long way out into Vegas, where you need the capacity to take 3,000 delegates. These do tend to have a shorter booking window.

In terms of the IFRS 16 question, there are some very technical aspects of the accounting around that. I am happy to follow up with it offline and we will, of course, pull out all the detail around it at the full-year results.

Tim Barrett: How much of the \$10 million is it, roughly?

Paul Edgecliffe-Johnson: It's a little bit more than 50%.

Alex Brignall (Reburn): Morning guys, thanks very much, just one, really. You guided and have guided historically that you would expect RevPAR growth to remain positive whilst GDP growth is positive but I guess in the US that has not been the case for at least a couple of quarters and you talked about timing and how Q3 might be better but it has not been. Have your expectations changed at all? What else is happening that means that RevPAR growth is worse than really macro factors would tell us it should be and how does that affect your expectations for next year? Should we assume that the old formulas come back and we get RevPAR growth again or should RevPAR growth just stay worse? Thank you.

Paul Edgecliffe-Johnson: Thanks Alex. So, I think we have spoken previously about that: if you go back over the long run and you look at how RevPAR trends to GDP growth, it does tend to trend ahead of GDP growth over the long run and that is what we have seen for many years of the cycle. I think in referencing a weaker RevPAR environment in the third quarter and pulling out the particular segments where we are over-weighted to and both segments in terms of those manufacturing and auto segments and in terms of the group's area where we are over-weighted, too, again. Because of the nature of our full-service Holiday Inns and Crowne Plazas we try and give a little bit more colour as to if there is any movement away in the current quarters from that long run trend, what could be driving it. I cannot give you, based on a quarter, an analysis of whether we will see a longer-term deviation from that trend. I can only give you the most latest colour. So I think we will need to look over a period of time and if there is any deviation, try to get our heads around that but that is all I have for you today.

Alex Brignall: Thanks very much. I guess just one quick follow up. The OTAs recently have been saying that, should there be a downturn, they expect hotel prices to be worse because transparency is higher. Is that something that you would have within your expectations?

Paul Edgecliffe-Johnson: It is an interesting question. I would not necessarily agree with that. The OTAs were around last time they went through it and I think that what you tend to see, in the event of a downturn, is that the midscale, upper-midscale brands do outperform. We certainly saw that last time around and consumers are very attracted by strong loyalty offers; of course, we have the largest loyalty programme, with IHG Rewards Club. So I would actually expect to see even more business come to us in the event of any sort of downturn like that. We have expanded since 2008 the penetration we have in those segments, so I guess we should all see. Revenue management is what comes into play at that point. If occupancy does slacken in the market, what do the general managers of the hotels on the street corner do? Do they reduce pricing, or do they accept that occupancy is slackening from a level that we have never seen before in the industry and just let that slacken off a little bit but hold pricing, which would be the most rational response? We have very sophisticated revenue management algorithms, price optimisation tools, in our Concerto tool that we have spoken about, we have rolled out, together with the GRS programme, which should support that.

Richard Clarke (AB Bernstein): Good morning; three questions from me, if I may? You have flagged that you have a substantial liquidated damages inflow coming in. Presumably that is the Macau Holiday Inn or maybe the London Holiday Inn but any trend there? Why are owners paying to get out of IHG contracts, or are these just one-offs?

The second question was cash return: I think the last cash return was at Q3 last year, so any updates on when we might be able to expect the next cash return? Then the third one, on Saudi Arabia: Saudi Arabia is opening itself up, IHG I think is the number one hotel chain in Saudi Arabia, so what is the potential upside from that move by the Saudi government?

Paul Edgecliffe-Johnson: Thanks Richard. So, on your concerns on liquidated damages, our contracts are very strong and there may be a reason why an owner will have a better use for a hotel and sometimes it may be there is redevelopment on the site, it may be lots of different reasons. Actually, although we do not call out individual hotels in which it is, it is not either of the ones that you referenced there but we will not get into a guessing game, so you have had your two guesses.

In terms of cash returns, yes we did at the third call last year. Nothing to announce today, obviously but the philosophy around the business model has not changed. We continue to be very cash-generative, we continue to be very focused on our margin, on our cost efficiency and on driving our long-term growth, so absolutely no change to our philosophy there.

Saudi Arabia is an interesting market. As you say, we are very well represented. We have the best location in Saudi, Makkah, for the InterContinental there. We have quite a number of signings in Makkah. We have the new voco that we have done in Jeddah as well. We have very strong reputation for our brand there and I think there will be an opportunity for more hotels in due course and we are actually continuing to invest behind our operations and on-the-ground support teams there to make sure, as we always try to do, that we can support our owners to the very highest level, which is what they expect of us.

Monique Pollard (Citi): Hi, morning Paul. Three questions from me, if I can? Firstly, the \$5 million Hong Kong fee reduction in the second half, I am assuming that annualises going into next year, all else being equal? Also, related to that, could you give us an update on how long we should expect Hong Kong to be a drag once the protests have ended in the region? Also, could we talk a bit about if the environment were to get materially worse from here? I understand your point that at the moment you continue to invest for growth for the long term. However, if it were to get materially worse, what kinds of cost-saving measures could you look at? I know in the past you have mentioned things like staff bonuses, wage increases, travel and expense budgets. Perhaps if you could put some numbers around that, that would be quite helpful.

Then, finally, just coming back to the cash returns question, I guess leverage range at the moment stays unchanged in terms of targets. If the environment gets worse from here, do you think there is scope that you take a more cautious approach to leverage, or are you still happy with where it is?

Paul Edgecliffe-Johnson: Okay, thanks Monique. In terms of Hong Kong and the fee reduction that I have called out for the second half, if conditions stay similar to what we see today, if they stay at that sort of level into the first half of 2020, then yes, I think we will continue to see an impact and it could be proportionally around the same. If there is any difference in that then we would call that out at full-year results. However, I would not think that it is going to be materially different from that.

In terms of how long the drag might last, obviously after the protests would stop, because you would not expect me to have a perspective as to when they might stop, then based on our experience of the Occupy Central protests a few years ago, there was a lag before business picked back up again. So business did not just arrive back at the doors as soon as the protests finished. It could be different this time around, so we will keep a close eye on that but that would be our historic experience.

Then, in terms of your questions as to, I guess, the resilience of the business model, as you know, it is a very resilient business model, helped firstly by the fact that we are opening up a lot of hotels around the world. That is the first dynamic. So even if you saw a RevPAR environment which was tougher than we are seeing today, then we have 5% growth in our system size, which is what we expect for this year, which will then annualise into next year and then a further strong performance in our system size growth in 2020. That brings in a lot of new hotels which generate income for us, so that is obviously a great benefit in neutralising anything that we might see in the RevPAR environment.

Beyond that then obviously we set, as all companies do, a level of profitability and other targets, which is what drives corporate bonuses. If that were not obtained then that has an impact on corporate bonuses which just automatically flows back through into the EBIT line.

Then there are other things that, if we saw a further deterioration, we would look at. We did that through 2001 and then back in 2009, so we have a well-established playbook, both at the corporate level and at the hotel level, of course. So, having been around for such a long time as a company, there is very little that we have not seen.

I guess the important point to note, though, is that we are still investing for growth very significantly. We took costs out of our back office; we are putting them back into our front office to make sure that we have all of these engines to deliver our industry-leading net system size growth over time.

In terms of cash returns, our philosophy around cash returns has not changed. Our focus on cash generation has not changed, so there is nothing that I would call out there today. Thanks very much, Monique.

Jarrold Castle (UBS): Good morning Paul; I will just limit it to two. One: any change in thinking on M&A? In this environment, are sellers becoming more realistic in terms of multiples?

Then, secondly, you touched on GRS contracts, so any comments on upselling ancillaries? How is that going in terms of squeezing out some further revenues? Thanks.

Paul Edgecliffe-Johnson: Thanks Jarrod. In terms of M&A, really our thinking has not changed, that the strongest return on capital employed for us is launching new brands and that is what we have done in most cases. Back in time, even Holiday Inn Express was a brand launch for us and more recently avid, which is performing very strongly, voco, Atwell Suites, etcetera, etcetera.

In the Luxury segment, where it is more difficult to create a brand from scratch because we really have to buy the real estate to put our brands onto it, it makes more sense to buy something that has a lot of growth opportunity. So we do not like, necessarily, to buy a brand that is ex-growth, that is so large, with maybe hundreds of properties and in most of the territories it can be at because I think that is a very expensive way to get into that opportunity. We would rather buy something and then take it internationally, like we did with Kimpton, or buy something that has very strong brand equity but really needs more investment behind it, like with Regent, or buy something that is the industry leader but with the benefits of being plugged into a global system can expand even further, like Six Senses. So really no change to the philosophy there. We are very picky, I would say and our pickiness has not changed.

In terms of GRS, I am really pleased with the rollout there and the opportunities that it is going to offer, for us being the first hotel company with a cloud-based GRS. The great benefit of that is we can beta test new initiatives: just put them down into a certain subsegment of our hotels, into a brand or different locations and try different things, see how that works, take it back and rework it if we want to. So there are lot of opportunities from that and there will be more updates on that in due course but nothing in this trading update, Jarrod.

Paul Edgecliffe-Johnson: Thank you everybody for listening in. I appreciate your time and hopefully we will catch up very soon. Just a reminder that we do have our China educational event on 31st October in London and there will be an opportunity to see that over the internet as well. Thanks very much, bye for now.

[END OF TRANSCRIPT]