Millennium & Copthorne (MLC), what now?

COLLINS SARRI STATHAM INVESTMENTS

Research Report

Report Date

29th January 2018

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A "covert war" 2007-2017

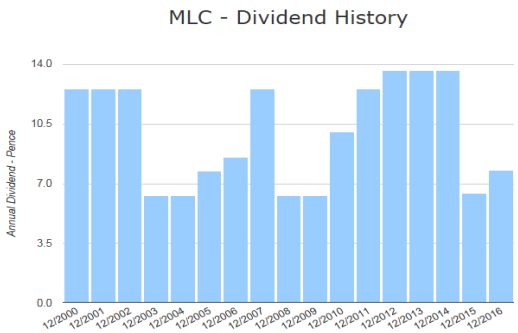
Back in April 2007 speculation was rife that a takeover of the MLC minorities was imminent. MLC hit 726p per share but the board refused to comment. Investors realized the false hypothesis and started selling. An 18 month bear market ensued, global events took control, by October 2008, MLC hit 160p per share.

Now surely, majority owner City Developments would seize the opportunity. But no. In statements, chairman Kwek Leng Beng spoke of the company being hit by a "*financial tsunami*". At a meeting, I recall Kwek commenting on the stock collapse "*MLC shareholders are lucky - some Singapore stocks are 1/10th of 2007 highs*".

But rather than state its intentions, City embarked on a 10 year "creep" operation that quietly increased its MLC stake. In 2008, City Developments held 52% of the subsidiary. By 2017 it was 65.2%. It is likely the Panel was involved as the operation abruptly stopped in 2017, short of the ownership level that would have forced an acquisition. The "creep" operation damaged institutional trust in City.

The MLC board in 2014 also took the unfortunate step of stopping its property valuation reviews. Ultra-low interest rates had been kind to Millennium & Copthorne's trophy assets. Estimates did the rounds that the stock's net asset value was over £10 per share, but the company obscured the market valuation, and hence the fact that its ownership strategy generated low returns on equity.

Kwek's dividend tinkering (3 major gyrations in 2 decades) alienated holders. The payout was cut in 2008 (to conserve £19m) but had risen since 2009, only to be cut again in 2015 back to 6.42p per share. The 2015 cut was badly received.



The 2015 dividend rebasing was unnecessary in our view and served to weaken investor interest, softening holders up.

Source:www.dividenddata.co.uk

UK institutional investors were disillusioned with MLC's ownership model. The shares had underperformed its peers, the larger hoteliers who employed franchising. The MLC listed minority was illiquid, with little analyst coverage.

According to a major institution "UK institutional investors have been pressing for an exit, via a liquidity event for years." Brexit made sterling listed assets cheap. By October 2017, after 2 years of talking down MLC's prospects, Kwek finally moved.

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Certainly anomalous.

A long term bear market has existed in this stock going back 17 years!

Source: www.google.com

What went wrong? What are the reasons for the failed offer?

There was a severe failure in "form" in the offers right from the start:-

- The M&C Independent Directors, advised by Credit Suisse, only disclosed talks with City Developments had taken place after the 552.5p offer had been agreed. Takeover talks were conducted in secret for 3 months. This prevented shareholders from participation in the process, specifically in addressing the issue of the Independent Directors, and was taken badly.
- The M&C Independent Directors were a soft touch, concerns were rife they were not independent enough. In M&A it is vital that the Independent Directors are seen as independent.
- Neither M&C Independent Directors nor the institutions succeeded in compelling City Developments to undertake an up to date independent third party valuation for all of its owned properties. As such minority investors were "flying blind" with no guidance on asset backing or realizable value. *This is a vital point due to Millennium's ownership of very valuable properties*, the Mayfair and Knightsbridge properties and abroad the Manhattan & Singapore portfolios and the Hong Kong and Seoul assets. MLC did disclose a £295m book valuation for three South Kensington hotels alongside a note that their market value was a combined £585m! This confirmed holders' suspicions that even in a takeover, MLC was obscuring valuations. As such there was an uneven playing field, only City Developments knew the true valuation.
- City Developments claimed using a net asset valuation was not appropriate in valuing MLC, whilst itself using net asset values for years! City denigrated the valuation methodology employed by the American dissenting holders.
- The desperate language used in the revised offer. The Independent Directors claimed a number of Group assets have "not had significant new investment for many years…. the Mayfair & Knightsbridge properties require £90m, Sunnyvale £200m, Seoul £90m". This seemed blatantly untrue. Millennium spent millions on refurbs in the last decade. The City Developments board also threatened a cut to the dividend to fund an enhanced refurb bill, if the offer failed. Surely this pushed the linkage too far. It sounded like a bullying tactic and it backfired.
- On the 23rd January 2018 the revised offer was clearly in trouble, MLC disclosed the acceptance rate was just 44.21%. This suggested the board had probably not convinced sufficient UK institutional owners, Fidelity, Schroders or Aberdeen. The read suggested at least 37% "against"; 44.2% "pledged" and 18.8% "holdouts" meaning MLC had to convince 30.8% of the holdouts to win. But by the 26th January, it only improved to 47.1%.

So what's next?

- On the 9th October my heart sank when I saw the initial 552p offer. As a holder myself, I thought it was derisory. At 620p the offer was low but it might have succeeded. But when the threats started, the institutions were in a dilemma, if they succumbed to this sort of thing, it would set a bad precedent. MLC became a reputational rather than financial merits decision. *The UK institutions now have to decide if continuing the journey with Kwek and the current board is right. It is likely some will exit.*
- The hotelier model is under siege from internet based competition, Air'B&B, Holiday Lettings etc. The death of the traveler market has had a profound effect on MLC, it is more reliant on corporate customers, but this market is dominated by the majors, Intercontinental, Marriot, Starwood, Hilton etc. Millennium is facing competitive threats and a response has yet to emerge. The operating outlook is not good. It would *not be a surprise if MLC lowers earnings guidance for 2018 (EPS 36.85p) and 2019 (EPS 39.85p) soon.*
- The emergence of vocal US based "value" investors is welcome. The group, International Value Advisers, MSD Partners (Michael Dell) and Classic Fund Management were key to the collapse of the offer by pushing for transparency. The episode has showed MLC's corporate governance is lacking. But will lessons be learned? I doubt it.
- Agapier Investments (the takeover vehicle) was 3% from its acceptance condition – maybe a positive. If Kwek does return in 12 months with 700p it might work. I do not believe his protestations that "further offers are very unlikely".
- What MLC really needs, management & strategic change at the top, it will not get anytime soon. It is likely Kwek returns to the long term pattern of reporting "hit or miss" results, buying and refurbing properties that offer low returns, hoarding properties. With pressure now off, I am not hopeful of immediate management or strategic change.

Conclusion

- The anomaly continues. MLC has a book value of £3.16bn (30th June 2017), and a parent co unwilling to pay over £2bn. Estimates made in March 2016 (pre Brexit devaluation) put a £4.8bn value on MLC's properties.
- The repercussions are unknown. Kwek/ City Developments could lift capital spending and cut the paltry dividend again, a negative outcome.
- Will Kwek/ City return? Yes we think so, especially if the American holders reduce their exposure. Their track record shows Kwek/ City are opportunistic buyers, a supporting factor.
- The failure of the takeover is positive in the sense that for the first time City Developments' approach has been given a kicking by a global investor base. Whilst I do not believe MLC will change internally, I hope I am wrong!

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