

Choice Hotels International, Inc

NYSE:CHH

Analyst: Florent Polito

Sector: Consumer Disc.

SELL

Price Target: \$32.28

Key Statistics as of 3/6/2016

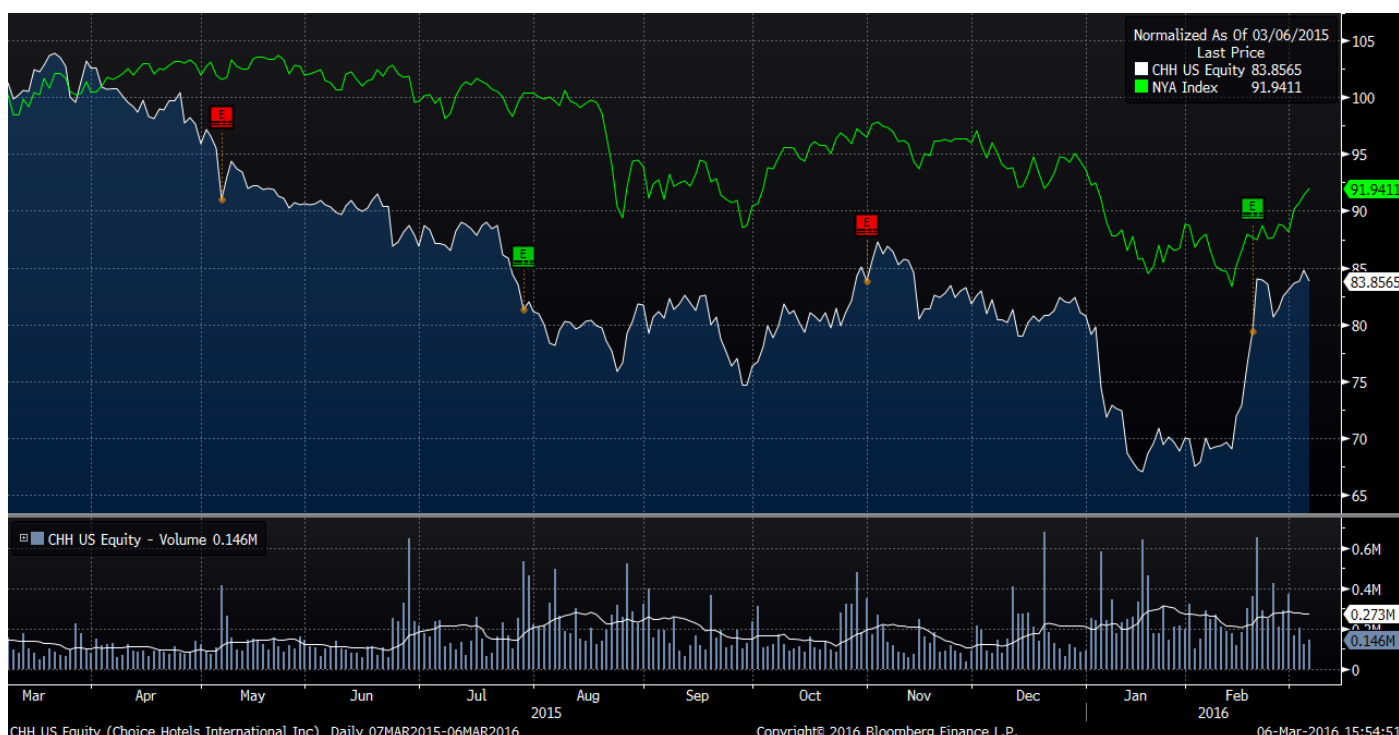
Market Price:	\$52.36
Industry:	Hotels, Restaurants and Leisure
Market Cap:	\$2,960M
52-Week Range:	\$41.85-64.85
Beta:	0.65

Thesis Points:

- Choice Hotels non-existence of customized experience is going to handicap their mid-term growth
- The underestimated rise of platforms such as AirBnB challenges the whole industry to a numb future
- The unjustified overreaction of the market after the last earnings is very likely going to balance soon

Company Description:

Choice Hotels is one of the largest hotel franchisors in the world with 6,423 hotels open, they operate in two reportable segment: the hotel franchising business and SkyTouch Technology division. SkyTouch is a division of the company that develops and markets cloud-based technology products, including inventory management, pricing and connectivity to third party channels, to hoteliers not under franchise agreements with the company. SkyTouch represents less than 1% and 5% of the Company's total revenues and operating expenses, respectively, for the year ended December 31, 2015. The company operates mostly in North America. The brand names include Comfort Inn, Comfort Suites, Quality, Clarion, Ascend Hotel Collection, Sleep Inn, Econo Lodge, Rodeway Inn, MainStay Suites, Suburban Extended Stay Hotel and Cambria hotels & suites.



Thesis

Just like cell phones almost erased the existence of land lines or the apparition of smart phones with camera made useless the job of photographer, what happens to the hotel industry with the development of platform such as AirBnB is more likely to cause a severe crisis for this industry which will have to rethink how it brands itself. The rise of the power of Millennials is challenging hotels companies such as Choice Hotels, which does not bring the customized experience that this generation is looking for. While the decline on the long-term is definitely in action, Choice Hotels which has shown an increase in its revenue is not understanding and facing this challenge yet, which is more likely to drown it in the mid-term when it will see how important customization is.

Industry Outlook

The hospitality industry is one of the oldest industry of our time, and has evolved over the centuries; now it is no more a simple brick-and-mortar industry where one arrives at the night in a place and simply search for a hotel around. From an interview by Deloitte we can notice that emerging platforms such as AirBnB and Uber are gradually becoming mainstream and challenging established players. In the race of traditional vs. alternative, the winners will be those who can create value for customers that they can experience and measure. A part of what Millennials want is a customized experience. The hotels that are best able to provide a customized, differentiated experience to customers will be winners in 2015 and beyond. Hotels have to find the right combination of personalization, design, ambience and technology to build lasting loyalty with the Millennial customer.

Porter's Five Forces

Bargaining Power of Customers: HIGH

Customers easily have access to a wide range of low-differentiated hotel, and it does not cost them anything to switch to another brand; while the hotel brands are trying to build a loyal pack of customers, through rewards and discounts, it almost makes no difference for the biggest part of customers when it comes to make a choice. Moreover, as a non-necessary product and with the rise of AirBnB offering low price with

customized experience, customers have become increasingly price sensitive regarding the hotel industry.

Bargaining Power of Suppliers: LOW

Most of supplies required for a hotel are either inexpensive or available easily, those expenses will comprise tissues, trashcans or food, that can be bought within a wide range of suppliers; actually the most significative need from suppliers would be labor, and most of hotel-related jobs require few skill and the labor is often cheap and abundant.

Existing Rivalry: HIGH

As said above, rivalry is high due to a poor product differentiation when it comes to hotel, and the development of online platform to facilitate the access to a wide range of different hotel while offering low prices increases the rivalry among competitors.

Barriers to entry: MEDIUM

Relatively few funds are required to enter in the hotel industry as it does not require an economy of scale to be profitable. Moreover the rarity of loyal customers makes it easy for a new entrant to grab a proportional share of the market, that is exactly what AirBnB has proven.

Threat of substitutes: MEDIUM

There is no real substitutes to getting a hotel room, except going to the camping, but AirBnB is offering a substitute significant enough where customers can benefit a fully customized stay.

What to remember from the last Earnings Call

Currently, the preoccupation of most investors concerns the profitability of SkyTouch which has been created in 2013, and has presently a negative EBITDA return, though it has been noticed to be close to 0%, this highlights how investors are not awoken to the fact that the present model of Choice Hotel is getting weakened by the development of AirBnB. This shows that Choice Hotel is overvalued for the moment. The company itself has not shown any concern with the development of the platform and its direct competitors, which shows that it is not going to revalue its model for a while.

Market overvaluation

CHH current price is \$52.36, and the target price has been calculated following a proforma of \$32.28. CHH stock price history shows that the recent increase in price has happened due to a positive surprise in the recent earnings; it is to be noticed that the previous positive earnings that has happened in August 2015 had led to a decrease of a stock, and the two negative surprise earnings had also led to a decrease of the stock price. As nothing really justifies the increase of the stock price because no significant news have been notified, we can expect that the market excitement has led to an increase of the stock price, which must be balanced within a few weeks. Moreover, the stock has underperformed the NYSE during the whole year.

Conclusion

Following the development of the hotel industry with its incoming crisis, and the instability of the actual model of CHH, added to the expectation of a market rebalancing of CHH stock price, CHH is definitely a short, which price is expected to decrease in the short-term. The table in the page below shows the valuation of the company, which shows no probability of a price increase.

Choice Hotels International Inc. (CHH)

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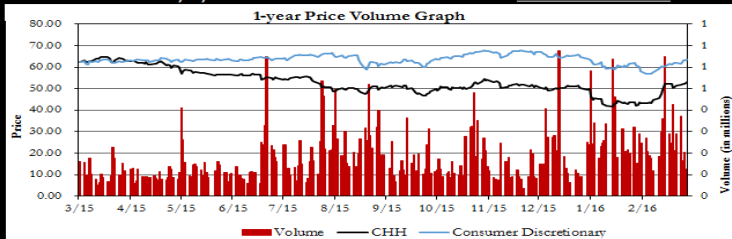
BEARISH

Analysis by Florent POLITO
3/6/2016

Current Price: \$52.36
Divident Yield: 1.6%

Intrinsic Value: \$29.26
Target Price: \$32.28

Target 1 year Return: -36.78%
Probability of Price Increase: 0%

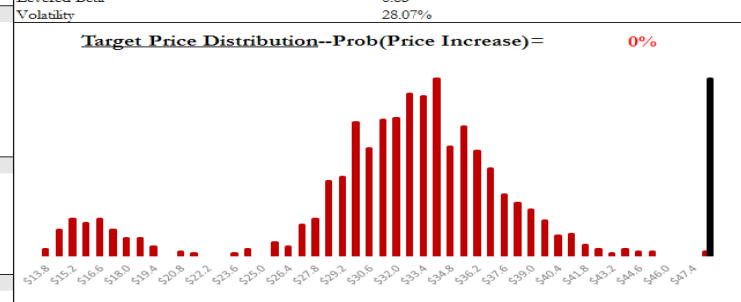


Description	General Information
Choice Hotels International, Inc., together with its subsidiaries, operates as a hotel franchisor worldwide.	Sector: Consumer Discretionary Industry: Hotels, Restaurants and Leisure Last Guidance: November 3, 2015 Next earnings date: April 30, 2016 Estimated Country Risk Premium: 6.22%
	Effective Tax rate: 39% Effective Operating Tax rate: 38%

Market Data	Market Data
Market Capitalization	\$2,949.78
Daily volume (mil)	0.15
Shares outstanding (mil)	56.34
Diluted shares outstanding (mil)	57.27
% shares held by institutions	65%
% shares held by investments Managers	61%
% shares held by hedge funds	2%
% shares held by insiders	24.00%
Short interest	3.66%
Days to cover short interest	8.36
52 week high	\$65.31
52-week low	\$40.78
Levered Beta	0.83
Volatility	28.07%

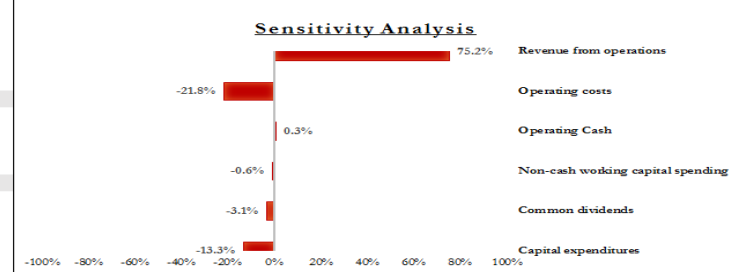
Quarter ending	Revenue	EBITDA
12/31/2014	3.51%	6.73%
3/31/2015	5.44%	-1.76%
6/30/2015	11.15%	2.60%
9/30/2015	4.02%	2.95%
12/31/2015	7.98%	-5.14%
Mean	6.42%	1.08%
Standard error	1.4%	2.1%

Total compensations growth	Total return to shareholders
8.67% per annum over 5y	4.63% per annum over 5y
15.23% per annum over 5y	4.63% per annum over 5y
16.1% per annum over 4y	1.75% per annum over 4y
12.18% per annum over 2y	30.96% per annum over 2y
6.21% per annum over 5y	4.63% per annum over 5y
N/M	N/M



Management	Position
Joyce, Stephen	Chief Executive Officer, Pre
White, David	Chief Financial Officer, Sen
Pacios, Patrick	Chief Operating Officer and
Wu, Simone	Chief Compliance Officer, Se
Pepper, David	Chief Development Officer
Hewitt, Eben	CHH Technology Officer

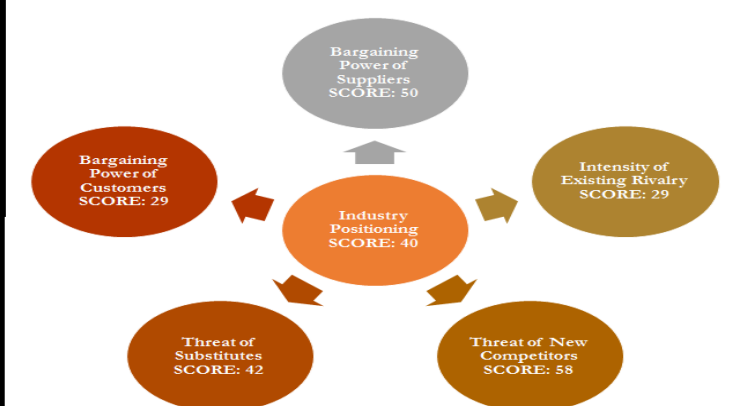
CHH (5 years historical average)	Industry (LTM)
39.35%	27.89%
22.91%	12.8%
1.72	2.17
41.33%	35.75%
20.47%	11.1%
2.02	3.21



Profitability	CHH (LTM)	CHH (5 years historical average)	Industry (LTM)
ROIC	29.7%	39.35%	27.89%
NOPAT Margin	17%	22.91%	12.8%
Revenue/Invested Capital	1.71	1.72	2.17
ROE	29.5%	41.33%	35.75%
Adjusted net margin	14%	20.47%	11.1%
Revenue/Adjusted Book Value	2.10	2.02	3.21

Invested Funds	CHH (LTM)	CHH (5 years historical average)	Industry (LTM)
Total Cash/Total Capital	28.7%	27.9%	19%
Estimated Operating Cash/Total Capital	26.7%	20.8%	N/A
Non-cash working Capital/Total Capital	-13.3%	-10.8%	-41%
Invested Capital/Total Capital	86.3%	84.9%	85%

Porter's 5 forces (scores are out of 100)



Period	Revenue growth
Base Year	13.4%
12/31/2016	4.7%
12/31/2017	2.7%
12/31/2018	2.7%
12/31/2019	2.8%
12/31/2020	2.8%
12/31/2021	2.8%
12/31/2022	2.9%
12/31/2023	2.9%
12/31/2024	2.9%
12/31/2025	3.0%
Continuing Period	3.0%

Valuation	ROIC/WACC
NOPAT margin	4.14
	4.14
	4.07
	3.83
	3.61
	3.44
	3.30
	3.17
	3.05
	2.93
	2.82
	2.72

Period	Invested Capital
Base Year	\$330.39
12/31/2016	\$434.25
12/31/2017	\$455.01
12/31/2018	\$561.24
12/31/2019	\$502.77
12/31/2020	\$581.61
12/31/2021	\$622.51
12/31/2022	\$648.80
12/31/2023	\$676.35
12/31/2024	\$699.64
12/31/2025	\$723.18
Continuing Period	

Net Claims	Price per share
\$808.33	\$29.56
\$678.69	\$32.61
\$516.01	\$35.92
\$356.27	\$39.31
\$175.02	\$43.12
\$19.24	\$46.58
-\$135.79	\$50.15
-\$290.05	\$53.85
-\$443.26	\$57.67
-\$595.37	\$61.63
-\$746.24	\$65.76