

HKICPA Business Case Competition 2019

Platin Hotels Limited

Overview

Platin Hotels Limited ('Platin' or the 'Company') is a long-established company whose shares are listed on the Hong Kong Stock Exchange. It operates a chain of luxury hotels, competing at the premium end of the market with the top international hotel groups. Platin commenced operations in 1979 with one hotel, the Platin China. This is Platin's flagship hotel; its most successful and the 'diamond' in the brand. Platin China is currently heavily promoting the hotel's 40 year celebrations.

It currently has one hotel in Shanghai; four in Southeast Asian countries and Australia and three in Europe. It also has a 50% share in a joint venture that operates another hotel in the USA. These hotels are located in prime city-centre locations.

All Platin hotels currently hold awards from business associations for the best business hotels in their city or geographical region.

The head office of the Company is located in Shanghai, China.

The premium hotel business

The premium hotel market is very competitive. All major city centres have several five-star hotels which compete to attract guests. They do not compete on price. Instead they try to attract customers by offering excellent facilities. All Platin hotels have indoor swimming pools and fitness centres or spas for their staying guests, and they employ highly-rated chefs in their restaurants.

In order to compete successfully, hotels need to spend extensively on renovation work each year to maintain or improve luxury standards. Capital spending on renovations is the main element in the annual capital spending programmes of most hotel groups. At Platin, capital spending in the year to 30 June 2019 was 5.6% of total revenue for the year, and the Board is concerned that this was insufficient.

Competition is extended to the internet world. Customers are able to provide their comments of the hotels via various social media. This needs operational resources to handle. Also, Platin is aware of the importance of extending the sales channel (e.g. travel agents, event planning company, hotel booking apps / website, direct sales),

With the economic downturn in Europe, occupancy rates at all premium hotels have been low throughout 2018 and the early part of 2019. Many companies have been cutting back on business travel and using conference calls more extensively, with the result that number of 'business' guests has been static and may have even declined slightly. There has also been only a small rise in the number of tourists using premium hotels.

Like all premium hotels, Platin earns its revenue from providing accommodation ('rooms'), its restaurant services and bars ('food and beverage') and other revenue-generating activities such as the hire of rooms for conferences and meetings. Some Platin hotels also earn income from renting retail space to luxury retailers ('commercial' revenue).

A large proportion of revenue from the restaurants comes from staying guests, particularly business guests, although some hotels are more successful than others in attracting 'external trade' from the general public.

The hotel industry is global and many business customers come from large international companies. These companies recognise global brand names in hotels, and often use the same hotels in all the cities that their senior executives visit. The fact that Platin has just eight hotels worldwide may put it at a strategic disadvantage to some of its major competitors.

China operation

Due to the Chinese government policy in encouraging the reduction of luxury spending on both public and private sectors, the Platin China is facing significant pressure on its income from food and beverage and rental charges on the luxury retailers tenant of the retail spaces.

In addition, the Platin China aware that some online hotel / home-stay booking websites are promoting to the business travellers for the stay in high-end boutique hotels, fully-furnished service apartments and villas which are managed by some famous hotel operators. In response to the competition, the Platin China is required to reduce its room charges in maintaining the room occupancy rate.

Economic conditions in the year to 30 June 2019

The past two years have been difficult for the premium hotel business, due to the global economic recession. In the year to 30 June 2019, total revenue for Platin was 10% lower than the previous year, and EBITDA and earnings per share decreased by less than 15%.

A major earthquake occurred in one of the Asian cities where Platin has a hotel, causing huge damage and disruption to the city and its business. As a consequence, the hotel in this city lost a considerable amount of business and also suffered a small amount of structural damage. The poor performance of this hotel during the year to 30 June 2019 is attributed to the time it has taken the city to restore itself to normal working.

Occupancy rates at most of the Company's hotels was disappointing. Several years ago, the Company was achieving an average occupancy rate of about 70%, but in the year just ended it was about 60%.

Profitability and other aspects of performance

In the past, the Company has relied on revenue growth for growth in its profits. As a consequence of the drop of revenue, combined with a lack of attention to cost control, profitability in the year to 30 June 2019 was disappointing. Revenue of HKD4,403 million was 10% lower than in the previous year and earnings per share, at **10 cents***, were lower than the previous year.

The Company experienced a volatile year in the stock market. Its share price ranged between a high of HKD15.50 and a low of HKD9 during the year. It currently stands at HKD11, valuing the Company's equity at HKD22,000 million.

Selected information on income statement, statement of financial position and statement of cash flows is shown in Appendix 1.

The Company values its hotels in the financial statements at cost less depreciation and impairments. A professional market valuation of the hotels estimates their current market value at 15% above their cost model value.

* Previously stated as 49.8 was a typo.

The financial performance of each hotel is measured individually. Performance has been monitored mainly in terms of revenue. The profitability of each hotel is measured by charging attributable direct costs to each hotel and an apportioned share of head office operating costs on the basis of 5% of revenue.

A statement of the revenue and operating profit of each hotel is shown in Appendix 2.

The main measures of performance for each hotel have been average revenue room per day (ARR) and revenue per available room per day (RevPAR). These are shown in Appendix 3.

Platin has a 50% interest in a hotel in a major city in the USA. This was established only two years ago and is currently making a loss. Platin has also provided substantial financial investment in this project, including additional loans during the year to 30 June 2019. Although this hotel is loss-making, revenue is growing quickly and there are strong indications that the hotel will move into profit next year and could be a very successful investment.

Board of directors and senior management

The board of directors (the 'Board') of Platin consists of 11 members.

The chairman Wallace Wang has been with the Company for many years, and is a major shareholder in the Company. Although he is now quite old, he retains a keen interest in the Company and its future development. He is non-executive.

There are three executive directors:

- Martin Ma: Chief Executive Officer (CEO)
- Lily Li: Chief Operations Officer (COO)
- Chris Cao: Chief Finance Officer (CFO)

There are seven other non-executive directors in addition to the chairman. One of these, Peter King, is a lifetime friend and business associate of Wallace Wang. The other six non-executive directors are independent, to the satisfaction of the Hong Kong Stock Exchange.

Martin Ma, a Hong Kong CPA, is a recent appointment to the position of CEO. Aged 37, he already has extensive experience in the hotel industry, and believes that substantial changes are needed to restore the Company to strong growth.

Although the Company has a CEO and COO, a large amount of authority is delegated to the hotel managers. As stated above, the performance of each hotel is measured individually. Each manager is given extensive freedom to develop their hotel and its activities, and they have a major influence on decisions about renovation and improvements, subject to spending limits in the renovations budget. Each manager is personally accountable for the performance of their hotel.

Martin Ma suspects that although hotel managers have the authority to make decisions for their hotel, many of them are reluctant to innovate. This is because they are aware that if they take an initiative that is unsuccessful, they will be held personally accountable.

A management committee meets every four months. This consists of the CEO, COO, CFO, chief accountant and the hotel managers.

Corporate social responsibility

The Board promotes the concept of corporate social responsibility (CSR) within the Company. CSR is seen as a combination of promoting sustainability and environmental issues, being a fair and considerate employer; and engaging with local communities in the cities where the hotels are located.

Employment policy is decided at head office, but responsibility for other CSR initiatives is delegated to hotel managers and as a consequence Platin does not have an integrated company-wide CSR policy.

Last year one of the hotels in Europe attracted publicity by announcing an exclusive supply arrangement with an ISO 14000-certificated seafood supplier for the supply of fish to the hotel from sustainable sources.

The Company has not yet developed a CSR policy and this has now become a high priority to the business due to pressure from the competitors, the operating environment and the consumer. The Board has identified five key areas for their future company-wide policy:

- Sustainable food sourcing and management
- Water management
- Community partnership
- Guest engagement
- Waste and energy management
- Rainforest protection

The Board has decided to introduce some CSR measures into the Platin China as a trial before developing a wide-ranging company policy and implementing it across Platin.

The Platin China is currently trialling three CSR initiatives:

- 1 Sustainable food supply practices – the Platin China is only serving sustainable seafood and is advertising this on all menus and relevant marketing material
- 2 Water management – the Platin China is requesting guests to indicate whether they want new linen on a daily basis and advertising this as a water-saving measure in all the rooms
- 3 Community partnership – the Platin China is running a promotional month where 10% of all proceeds from their 'Charity High Tea' is being donated to workers on tea plantations through Charity International, a local charity organisation.

Recent incident

Last year, the manager of the Platin China retired after 30 years in charge. The new manager, Wendy Wang, has been operating the hotel for nine months and was appointed by the Board. Wendy has over 20 years' experience in hotels and a Hong Kong CPA, and has been with the Company for her entire career. She has proved herself as a competent hotel operator, and was manager in one of the Europe hotels for three years prior to this appointment. Wendy is also the daughter-in-law of Wallace Wang (company director and major shareholder).

All Platin hotels run a luxury day spa with massage treatments, beauty treatments, spa, steam room and relaxation area. Hotel guests are given free vouchers to use the spa services. Company-wide policy states that these free vouchers are only for hotel guests and it is strictly against company policy to open up any spa services to the general public or to be used as a 'perk' for family and friends.

In direct contravention of this policy, Wendy has been giving free vouchers for the day spa to a broad group of friends to use at the Platin China since she started managing the hotel. She has given out a total of 100 free vouchers.

Yesterday, Wallace Wang, the Chairman, was interviewed by "SPA For Business Travellers" Magazine asking for the change of hotel spa offering to non-hotel guests. As he has no clues on this, he did not give a concrete answer.

Appendix 1: Summary financial statements for year to 30 June 2019

Platin Hotels Limited

Selected information on income statement for the year ended 30 June 2019

(All figures are in HKD millions)

Revenue		4,403
Operating costs		
Materials and inventories costs	459	
Staff and related costs	1,680	
Other costs	<u>1,558</u>	
		<u>(3,697)</u>
EBITDA		706
Depreciation		<u>(370)</u>
Operating profit		336
Net financing costs		<u>(48)</u>
		288
Share of loss of 50%-owned joint venture		<u>(51)</u>
Profit before tax		237
Taxation		<u>(38)</u>
Profit after taxation		<u><u>199</u></u>

Platin Hotels Limited

Selected information on statement of financial position at 30 June 2019

(All figures are in HKD millions)

Fixed assets		34,701
Long-term investment		2,738
Financial derivatives		42
Cash		658
Other current assets		<u>589</u>
Total assets		38,728
Bank overdraft	21	
Borrowings	2,353	
Financial derivatives	220	
Other liabilities	<u>1,412</u>	
Total liabilities		<u>(4,006)</u>
Net assets		<u><u>34,722</u></u>
Share capital and premium (2000 million shares)		4,935
Retained profits		<u>29,787</u>
		<u><u>34,722</u></u>

Platin Hotels Limited

Selected information on statement of cash flow for the year ended 30 June 2019

(All figures are in HKD millions)

EBITDA		706
Change in working capital		(75)
Tax paid		(39)
Fixed asset purchases		(247)
Loan to joint venture		(600)
Finance cost payments		(73)
Dividend payments		<u>(92)</u>
		(420)
Interest income	25	
Net new bank borrowings	<u>300</u>	
		<u>325</u>
Net cash flow		<u><u>(95)</u></u>

Appendix 2: Hotels: revenue and profitability

An analysis of the revenues, costs and profit of each hotel is shown in the following table. All figures are in HKD millions. The hotels are identified by letters, not their city location.

	Analysis of Revenue							
Platin Hotel	Rooms	F&B	Commercial	Other revenue (Note 2)	Total revenue	Direct costs	Allocated costs from Head Office	Operating profit
China	427	363	370	65	1,225	1,075	57	93
Rest of Asia								
Hotel A	169	80	140	20	409	356	21	32
Hotel B (Note 1)	107	77	3	18	205	185	11	9
Hotel C	206	289	33	25	553	482	28	43
Hotel D	200	152	4	28	384	325	20	39
Europe								
Hotel E	384	116	36	49	585	520	30	35
Hotel F	300	231	–	61	592	515	30	47
Hotel G	<u>310</u>	<u>103</u>	<u>–</u>	<u>37</u>	<u>450</u>	<u>389</u>	<u>23</u>	<u>38</u>
Total	<u>2,103</u>	<u>1,411</u>	<u>586</u>	<u>303</u>	<u>4,403</u>	<u>3,847</u>	<u>220</u>	<u>336</u>
50%-owned joint venture								
Hotel H	261	207	–	30	498	600	–	(102)

Notes:

- Hotel B is the hotel in the Asian city damaged by the earthquake.
- 'Other revenue' includes revenue from chargeable hotel services, the provision of conference rooms and meeting rooms, charges for wedding receptions and also recognised income from non-returnable room deposits.

Appendix 3: Hotel performance measures

Hotel	Rooms revenue	Number of rooms available	Occupancy rate	ARR (Note 1)	RevPAR (Note 2)
	HKDm		%	HKD	HKD
China	427	310	75	5,032	3,774
Rest of Asia					
Hotel A	169	350	48	2,756	1,323
Hotel B	107	180	45	3,619	1,629
Hotel C	206	300	52	3,618	1,881
Hotel D	200	325	70	2,409	1,686
Europe					
Hotel E	384	240	75	5,845	4,384
Hotel F	300	320	60	4,281	2,568
Hotel G	<u>310</u>	<u>340</u>	<u>65</u>	<u>3,843</u>	<u>2,498</u>
Total/average	<u>2,103</u>	<u>2,365</u>	<u>61.3</u>	<u>3,974</u>	<u>2,436</u>
50%-owned joint venture					
Hotel H	261	350	50.0	4,086	2,043

Notes:

- 1 ARR = Average revenue per room per day.** This is the revenue from accommodation (rooms revenue) divided by the average number of rooms occupied and divided by 365 days.

Average number of rooms occupied = total number of rooms available multiplied by the occupancy rate.

- 2 RevPAR = Revenue per available room per day.** This is the revenue from accommodation (rooms revenue) divided by the total number of rooms available occupied and divided by 365 days.

RevPAR may also be calculated as ARR average revenue per room multiplied by the occupancy rate.

Your Action

You are a Hong Kong Certified Public Accountant working in the Business Analyst Team under Lily Li, COO. This morning, she showed you the below email.

Lily is planning to have your team explaining the free voucher issue to Wallace together with a business proposal for improving hotel group performance.

The free voucher issue is expected to include comment on any ethical concern, internal control as well as Platin's policy compliance and response to the magazine.

The target is to have 15-page business proposal starting with executive summary of not more than 5 pages.

