Christmas Idea #1: Radisson Hospitality $RADH

Earlier this week, I introduced this year's Christmas Ideas series and presented some "honorable mentions." Today, I'm diving into my first Christmas Present Idea: Radisson Hospitality (RADH, trades in Stockholm. Disclosure: this is a semi-illiquid international stock which I am long; please do your own due diligence).

Radisson may be familiar to longtime readers by another name. The company changed their name from Rezidor earlier this year, and I actually wrote them up in February. I'd (strongly) encourage you to read that post for a good bit of background (particularly for a discussion of peer multiples and valuation), but the high level overview is that at the time I wrote Rezidor up I thought they were the cheapest hotel company on the public markets. In addition, the company had just started a turnaround plan that could substantially lift profits over the next few years. Combining a cheap stock with turnaround potential presented shareholders with mammoth upside if things went correctly, but investors seemed to be avoiding Rezidor because of the overhang from their majority owner, HNA.

Since that post, a lot has changed at Rezidor. First, they changed their name to Radisson Hospitality in early May. They've also continued to execute on their turnaround plan, with EBITDA for the first nine months of the year up ~33%.

However, the most meaningful change, by far, has been their ownership change. In August, HNA reached an agreement to sell their shares to a consortium lead by Jin Jiang for SEK 35/share. Jin Jiang closed on that share purchase in Mid-November, and, under Swedish law they were required to make a bid for the rest of Radisson's shares within four weeks (they could also sell their stake down below 30%, but given they had just bought the stake and would almost certainly need to sell at a discount to the price they had just paid, a sale seemed unlikely). Jin Jiang's offer came out earlier this week: SEK 40/share to take out minority shareholders. The offer will open up on January 7 and close on February 1. If Jin Jiang gets enough shares tendered to reach 90% ownership, they will be able to buy out all minority shareholders at that level and take the whole company private. Radisson's board will issue its "view" on the offer sometime during that period but "no later than... January 18."

The offer period presents a whole bunch of questions for shareholders:

- Will the board recommend the current offer?
- Will the current offer go through? How much would the board's recommendation sway the odds of the deal going through (i.e. if the board recommended rejecting the offer, what are the chances shareholders still tender enough to go through and vice versa)
- If the offer doesn't go through, would Jin Jiang raise their offer to try to hit 90% and take everyone out? What happens to minority shareholders if the offer doesn't go through and Jin Jiang chooses not to raise their offer / leaves minority shares outstanding.

These are all really interesting questions. With Radisson currently trading for ~SEK 40/share, the market appears to be assuming the the current deal will get done as is (or maybe pricing in a small chance of a small bump). I don't think that's right: I think Jin Jiang will need to raise their bid, likely substantially, in order to win board support and takeout minority shareholders, and I think Jin Jiang will end up doing exactly that.

Let me start with the obvious: why do I think the offer, as currently constructed, will fail? I think the board will reject the offer as inadequate and, regardless of what the board does, I don't think enough shareholders will tender into the offer for Jin Jiang to hit the "forced takeout" level of 90% ownership.

The reason I think shareholders won't tender and the board won't recommend are related. Recall that when HNA took majority control of Radisson (Rezidor at the time), they offered to take out all shareholders at just under SEK35/share, and Rezidor's board at the time rejected the offer as inadequate. HNA eventually went through with their offer and did not hit the 90% threshold, and Rezidor remained a publicly traded company under HNA control (even if HNA had hit 90%, I suspect their liquidity problems at the time would have meant they could not have taken out the remaining minorities). Radisson has gotten substantially stronger since that HNA offer; EBITDA, for example, was ~€80m in 2016 and will likely come in around €110-120m in 2018, and the company seems well on their way to achieving their 5 year operating plan of ~€190m in EBITDA in 2022. The HNA offer that the board rejected in early 2017 implied an LTM EBITDA multiple of just over 7x; if we applied the same multiple to today's EBITDA, Radisson would be worth between SEK 45-50/share (the current 40 SEK offer values RADH at ~6.5x LTM EBITDA; see cap structure below). However, given Radisson's improved prospects and the board's argument the old offer was inferior, I suspect that Jin Jiang would need to offer a higher multiple than the old HNA offer in order to get the current board "on board".

Shares		172.05	Diluted Q3'18
Price	SEK	40.00	
Market Cap	SEK	6,882	
In Euro	€	671.13	
Net Debt	€	3.40	at 9/30/18; per earnings release
EV	€	674.53	
LTM EBITDA	€	103.50	
EV / LTM EBITDA		6.5x	

Even if the current board were to accept today's offer of SEK 40 (I don't think they will, but humor me), I doubt enough shareholders would tender for Jin Jiang to hit 90%. Radisson is a relatively illiquid stock, and shareholders were offered the chance to cash out less than two years ago at ~SEK35/share. If you're a large shareholder and didn't cash out for HNA's offer then, I'm guessing that you still own most of your stock (it would be tough to sell a decent bit of it) and an offer of SEK40 today (at a lower EBITDA multiple!) isn't going to make you budge, particularly given the improvement in earnings since the prior bid. In fact, I'm not sure a bid of SEK50 would be enough to get enough shareholders to tender; at that price, shareholders would still be tendering Radisson at a discount to where their peers trade (at 50 SEK, RADH would be selling for ~8.1x LTM EBITDA; you can find some peers and multiples in my original article. Today, most peers are trading at ~10x EBITDA and I'd note that Accor recently launched a tender for Orbis, a loose Radisson comp, at 8.5x EBITDA) despite Radisson's significant upside potential (much faster than peer earnings growth) as the 5 year plan continues to progress. It would take a price approaching SEK60/share for Radisson's multiple to start approaching peer levels. I think you could make a theoretical argument that even SEK60 may be too cheap given shareholders would be tendering at a multiple around peer levels and getting no real acquisition premium... but I suspect if and when the offer started to creep over SEK50 shareholders would be quick to take the win and move on.

Bottom line: if Jin Jiang wants to win board endorsement and takeout minority shareholders, I suspect they will need to substantially increase their current offer. Will they?

I think the answer is yes, Jin Jiang will raise their bid. I base this on three reasons

1. Even if Jin Jiang raises their bid substantially, they will be taking out Radisson at a small discount or inline with peers current valuations, allowing Jin Jiang to capture all of the upside potential from the five year plan for themselves. That's a lot of value creation potential (In my previous post, I estimated RADH would be worth >SEK 100/share if they hit their 5 year targets; obviously that needs to be discounted a bit given there's no guarantee they do hit their targets but that is a lot of upside potential that Jin Jiang can capture for themselves!)
2. Taking out minority shareholders has significant synergies for Jin Jiang and Radisson. It eliminates real compliance costs and the management distraction of needing to deal with minority shareholders (I believe Swedish law has protections in place for minority shareholders that are quite costly from both a time and money perspective for a company to comply with, so taking minorities out would let Radisson dodge those).
3. Jin Jiang's current bid suggests that they actually want to own all of Radisson.

The last point is worth diving into. When the HNA / Jin Jiang deal was announced, a lot of people wondered if this was a stealth bailout for HNA (HNA gets desperately needed liquidity plus saves face by selling their stake for a slight profit to what they just paid). If it was a bailout, then you would think Jin Jiang had no real desire to takeout the rest of

RADH's minority shareholders, and Jin Jiang would do the bare minimum to comply with Swedish takeover law. In this scenario, Jin Jiang would bid SEK 35/share for the minority RADH shares (i.e. the bare minimum required by law / what they paid HNA for their shares), let the tender fail, and then just run Radisson as a controlled company and deal with the headache of minority shareholders.

That is not, however, what Jin Jiang did. While SEK 40 is likely an inadequate bid to get a deal done, it is a pretty meaningful bump from the SEK 35 they paid HNA / were required to bid. That bump suggests to me that Jin Jiang wants to own all of RADH. In fact, I think that first bump puts Jin Jiang in a really nice position to control the process: they can constantly point out to shareholders that their bid is a substantial premium to the unaffected price RADH traded at (never mind the price was heavily affected by HNA's distress / shareholder fear HNA would try to loot RADH) and talk to shareholders one by one to pinpoint the absolute minimum level they can bid that would get them just over the 90% threshold to close the RADH deal and squeeze out the rest of minority shareholders (they can also press shareholders by reminding the ones who turned down HNA's initial tender that RADH's stock drifted down to ~SEK 25 post-tender because few investors care about an illiquid semi-microcap stock; I think shareholders can counter that by pointing out the growth track RADH is currently on should result in substantial cash flows / dividends / upside, but at some point that illiquid argument is going to start picking off investors). Jin Jiang's bid is almost devious in that regard: if they had opened with a bid at too much of a premium, they may have "overpaid" what they could have gotten RADH for if they had really worked shareholders, and if they had bid too low a premium shareholders and the board would not have taken them seriously and event driven investors probably wouldn't have thought the stock was interesting to get involved with / Jin Jiang wasn't interested in negotiations. (In some ways, the Jin Jiang /

Radisson bid reminds me of the initial Dell bid for DVMT; it's clearly inadequate and almost certainly won't go through, but by putting a bid with a decent premium on the table it puts them in incredible position to control the process and pick off just enough shareholders to get a deal done)

So how do I think this all plays out? I think the board will reject the current offer, a bunch of event driven investors will get involved, and Jin Jiang will eventually bump their initial offer and manage to just hit the 90% threshold and takeout all shareholders. I expect RADH's turnaround will continue to go well, and Jin Jiang will make a killing on the position.

What's the downside here? Well, the obvious and largest risk is Jin Jiang doesn't meet the 90% threshold required to squeeze out remaining shareholders and doesn't bump their bid and the tender fails. In that case, we could be left with an illiquid controlled stock that no one's willing to get involved with (remember RADH drifted from the mid 30s to low 20s after the initial HNA tender, though some of that was certainly due to HNA distress). That's certainly a risk, but I think it's tempered by two things. First, if you are really worried about "illiquid stock drift", you could always buy RADH now hoping for a bump and simply tender into the current offer whether or not it gets bumped (again, this is why Jin Jiang is in such great position: by putting an initial offer on the table, they can get event driven funds who just want a small bump to hop into the stock and negotiate against them instead of perhaps more passive smaller shareholders who just wouldn't respond and wouldn't tender). Second, if you held RADH through the tender (i.e. didn't tender and didn't get taken out), you'd still be buying RADH at an attractive multiple with the turnaround plan just starting to gain speed. I wouldn't be surprised to see RADH's stock drift lower in the short to medium term if the tender failed and as some more event driven investors get bored and leave, but given the low valuation and some pretty solid cash flow metrics as the turnaround fully kicks in, RADH's stock is probably significantly higher in a few years if the current offer fails (PS I'm generally pretty dividend agnostic, but they can be helpful for controlled / illiquid stocks, so it's worth noting that RADH's dividend policy is to pay out ~33% of earnings; that's not a ton today but in a scenario where the tender fails but the turnaround really gains steam it could result in some interesting dynamics in a few years).