Belmond Limited: When Bad Corporate Governance Leads to a Great Investment

Thomas Braziel, B.E. Capital Management, Managing Partner

Executive Summary: Belmond, Ltd is a consortium of luxury hotels spanning Europe, Asia, Africa, and the Americas, luxury train services, riverboat cruises, and a New York restaurant built by business titan James Sherwood. Belmond has historically been a value trap which traded significantly below the retail price of its assets due to certain rights of Sherwood which prevented a sale. Recently, Belmond announced they were purchasing these rights and subsequently were seeking strategic alternatives.

Value Trapped:

Belmond Limited (NYSE: BEL) is a luxury service conglomerate consisting of hotels across five continents, luxury train services, and river cruises. The company is widely known and followed in the value investing community where it has been a value trap for over 10 years. The company founder, James Sherwood - https://goo.gl/QnGXTq, is a creative businessman with real vision and a nose for opportunity. He founded one of the earliest ship container leasing companies (Sea Containers - https://goo.gl/SjiLSH) and built the Orient-Express Group (Now Belmond - https://goo.gl/Y6ZxCf). Belmond began with Sherwood's 1976 purchase of the Hotel Cipriani in Venice for a mere £900,000 from the Guinness sisters. The Hotel Cipriani is now a single hotel within an incredible group of luxury Italian hotels at Belmond which generates roughly 40% EBITDA margins. The Hotel Cipriani itself is currently worth between $600m to $1b.

Although James Sherwood plays a role in why this investment opportunity exists, it is interesting to note that Sherwood is a business icon in his own right. Anyone looking for a great biography on business, identifying opportunities, closing complicated deals, and even general investment philosophy (told through the lens of purchasing hotels over the years) should check out Mr. Sherwood's autobiography Orient Express: A Personal Journey. This intriguing read walks through almost all of Sherwood's hotel acquisitions, the logic behind the deals, and the post-mortem on why some hotel investments worked out and others did not.

So needless to say, Belmond is an absolutely breathtaking group of hotels, with best in class EBITDA margins and RevPAR. So why hasn't the stock moved in a decade? Well, some would say they been poorly managed, some would say poor corporate governance, and lastly, some would say simply a lack of scale in the changing world of big hotel groups with large marketing budgets. Normally in such a situation an efficient, large-scale hotel operator could pay a significant premium to the public price of the company and modernize the operations of the properties. It could then fit the hotels into an existing brand and leverage their large networks for booking and reward points. Yet, this never materialized at Belmond. As will be shown, the reason lay with certain corporate covenants between Belmond and Sherwood.

The Power of 8Ks:

Recently a curious little 8K changed everything: https://goo.gl/W8rSNh. This 8-K discusses the company's purchase of Sherwood's right of first refusal on a sale of Hotel Cipriani and his option to purchase the hotel at fair value in the event of a change in control of Belmond. These two rights had effectively acted as a poison pill which prevented any company from purchasing Belmond outright, or, the sale of any hotels. These rights would nullify in the event that Sherwood passed away. At an age of 85 years, Sherwood realized that the only way to realize any value for the rights would be to sell them back to the company. Unsurprisingly after only a few weeks, the Company announced that they would review strategic alternatives: https://goo.gl/c8V57g

Variant Perception:

Without going further into the history of the company or an itemized list of assets and their value, it suffices to simply highlight what the market is missing:

1. Sleeping Assets: In addition to the hotel group, which values Belmond at anywhere between $15-20 a share using a traditional 15-20x EBITDA multiple, Belmond owns the 21 Club in New York and the Cipriani trademark within the UK and European Union. Both are sleeping assets within the Company that could be unlocked by the right operator with deep pocket (hint to Barry Sternlicht at Starwood!). Roland Vos, a Starwood protege, already runs Belmond as CEO. Each brand has fantastic potential to be thoughtfully expanded- for example, additional hotels, further restaurants, or food and beverage concepts, etc. The 21 Club has such loyal patrons that Bloomberg figured they needed to pen an article about it potentially changing hands (https://goo.gl/Sgg5Yu). It is difficult to quantify the value added by these sleeping assets, but they are real and should lead to higher valuations and more robust bidding.

2. The "Sheikh Appeal": While many of the leading real estate and hotel brands (Starwood, Colony, Marriott, etc) would bid $15-20 per share for the Company's assets (Deutsche Bank suggests $17 per share -https://goo.gl/muPPrU) these numbers miss the point. While the risk/reward of buying something for $16, and getting between $15 and $20 back seems good, you actually get something much better- **the unbounded optionality of every Sheikh, oligarch, despot, and nouveau riche bidding for the opportunity to purchase the world's premier and trophy hotel properties.** Frankly, many can borrow most of the capital needed to purchase them (see the same article for reference to a 2007 offer of $60 a share from a Dubai investment group as an example - -https://goo.gl/muPPrU).

Poor Corporate Governance:

Although there is potential significant upside in a sale of the company, especially to ultra-wealthy purchaser more concerned about status than economics, and little downside based on where the stock is currently trading, there is a timing risk. It is always the case that a deal could take significantly longer than expected to materialize, or, that the company could get cold feet. All “reviewing strategic alternatives” investment ideas suffer from this risk.

In this case the 8K that announces the sale of the rights also mentions that Sherwood gets additional payments if a deal is closed within ten years ($10M - $1M x number of years waiting) and an additional payment of $15M (for a total of $25M) if the deal is announced within six months. In Belmond’s case, the board of directors, while not containing Sherwood himself, is basically stacked with the friends of the founder. Therefore, we expect a quick sale of the company and a maximum payment of cash to Sherwood.

Risks:

Every investment situation has risks. In an event-driven situation the main risks center around the failure of the corporate event that acts as a catalyst. In the case of Belmond possible risks include:

- A deal is not announced within the 6 month time frame that causes maximum payout to Sherwood. A maximum payout for Sherwood gives the quickest turnaround for shareholders and an improved annualized return.
- The maximum valuation for Belmond comes from a non-economical, “status” buyer. If such buyer fails to materialize, an economic buyer will pay a lower price. The return in this scenario is attractive nonetheless.
- Failure of a buyer to purchase smaller assets, such as 21 Club. It is feasible that a potential transaction could arise as an asset sale of specific assets, which would likely result in a lower return.
- Due diligence finds the properties to be a state of unanticipated disrepair.
- If a buyer fails to realize in a material amount of time (for example, 1 year) it is likely that the stock price will fall to the pre-strategic review price of $11/share.

Conclusion:

Belmond possesses one-of-a-kind hotel properties, and in some cases irreplaceable, assets. These, plus the dormant assets, could fetch a price in the range of $18-20 per share in a sale to a global hotel brand and operator.

The real story, however, is the almost unbounded optionality of the “sheikh appeal”. This option could fetch a significantly higher price- possibly in the $20-$30 per share range.

Lastly, the Sherwood-friendly board means that a deal is extremely likely to be announced in the next 5 months that triggers the $25M payment to Sherwood. In my book, this is a great set-up.

Disclosure: We are long the equity and options of Belmond.