MELIÁ HOTELS INTERNATIONAL

COMPANY REPORT

HOSPITALITY SECTOR

JANUARY 2018

STUDENT: JOSÉ MIGUEL BRANQUINHO

21979@novasbe.pt

Promises of a pleasant stay

Enjoying the current favourable momentum

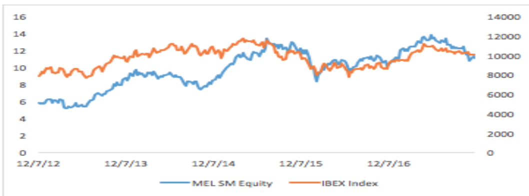
- **Positive macro backdrop**: For 2017, global forecasts expect the global economy to rise 2.7%, which will be the basis for a further increase of 2.9% in 2018.
- **Positive outlooks for the lodging sector:** Global International Tourism Arrivals increased 3.9% in 2016, comparing to the previous year, and are expected to continue this trend during the following years.
- **Towards an asset light model**: The future expansion pipeline is equivalent to 22% of the current portfolio and is composed by 90% new managed/franchised rooms vs 10% new owned/leased rooms.
- **Positive earnings momentum:** The planned portfolio expansion, combined with the current favourable macro backdrop should continue to support a generally positive earnings momentum for Meliá.
- **Recommendation to Buy:** With a 1-year upside of 50%, considering the dividend payment of 13.5 cents, the recommendation is to buy Meliá's stock, as it was reached a fair value of EUR 17.24.

Recommendation:	BUY
Price Target- FY18:	17.24 €
Price (as of 2-Jan-18)	11.66 €

Reuters: MEL.MC, *Bloomberg*: MEL.SM

52-week range (€)	10.30-13.99
Market Cap (€m)/ Free float	2640/ 48%
Outstanding Shares (m)	229.700
Major Shareholders:	Escarrer family (52.0%); Norges Bank (2.95%)

Source: Bloomberg



Source: Bloomberg

(Values in € millions)	2016	2017E	2018F
Revenues	1802	1920	2001
EBITDA	286	327	321
Net Profit	103	108	129
EPS	0.44	0.47	0.56
P/E	21.20	23.32	20.82

Source: Meliá's annual report and analyst estimates

Company description

Meliá Hotels International SA is a hotel company based in Spain. It owns and manages hotels and resorts, operating luxury, upscale and midscale hotels and resorts in Europe, Asia, The Americas and The Mediterranean. Its main focus is the bleisure segment.

Table of Contents

Executive summary

Leading resort hotel company worldwide

Meliá Hotels International is a hotel chain company headquartered in Spain, and currently is the leading resort hotel company worldwide, being Spain's leading hotel chain. The company has its main focus on providing hotel accommodation services, which include hotel accommodation, food and beverage sales, and other related experiences.

Towards an asset light model

In order to adapt to the fundamental changes that the lodging sector had faced after the financial crisis of 2009, the company started in 2011 to move towards a hybrid management model, favouring a low-intensity capital growth model. For this evolution, the investments in Joint Ventures were and continue to be a very important mechanism, as a way to minimize the risk and the amount of capital allocations, being the financial risk and return shared with the associate partner, and the operational part carried out solely by Meliá under a management model. With respect to this, the company future expansion pipeline expects to increase by 22% of its current global portfolio, being 90% under a management/franchised model and 10% under an owned/leased model.

Tourism is expected to continue to grow, boosted by the emerging countries

For 2017, global forecasts expect the global economy to rise 2.7%, which will be the basis for a further increase of 2.9% in 2018. The developing countries are expected to be the main drivers of this acceleration of global growth. Indeed, the region of Asia-Pacific will be the major contributor.

Regarding the demand for international tourism, it is expected to follow the positive trend of past years, mainly supported by the significant growth of tourism flows in the region of Asia-Pacific.

The target price for FY18 was computed through a Discounted Cash Flow model. The valuation leads to a "**BUY**" recommendation, with a fair value of **EUR 17.24.** Taking into account the 13.5 cent dividend payment, this reflects a one-year upside of 50%[1].

[1] Share price in 31/12/2017: EUR 11.50

Company overview

Company description

Meliá Hotels International is a hotel chain company founded in Palma de Mallorca, Spain, in 1956 by Gabriel Escarrer, and currently is one of the world's largest resort hotel chains, being Spain's leading hotel chain. The company has its main focus on providing hotel accommodation services, which include hotel accommodation, food and beverage sales, and other related experiences, such as casino activities and tour services. In addition, the company also operates under a vacation club, Club Meliá, which guarantees its members one week's vacation per year, for 50 years, in a selection of company's hotels. The company also owns a portfolio of real estate assets, representing 4% of total assets, where it carries out transactions of non-core assets, taking advantage of the pace of real estate cycles.

Exhibit 1: Meliá's brands

History Background

1956 marks the first hotel opening of Meliá, in the Balearic Islands of Palma de Mallorca, where from thereafter the company continued its growth. During the 70s, the company started to extend its business to other main tourist destinations of Spain.

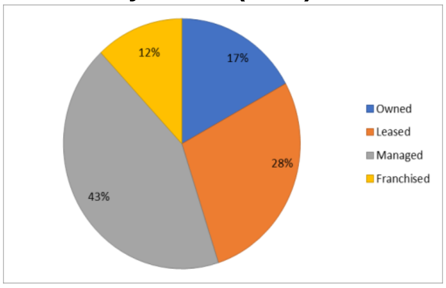
The 1980's decade marks a key turnover to the company, as the company opened its first hotel in the main Spanish cities, and, in 1985, the first international hotel, in Bali. Moreover, during this decade, with the purchase of 32 hotels from the Hotasa hotel chain, the company became the leading hotel group in Spain, fact that still continues to be true nowadays. In addition, the year of 1987 marks the acquisition of the Meliá hotels chain by Escarrer, which became the company's main brand.

The 1990's decade is defined by the development of the company in Latin America and also the introduction of the company's stocks in the Spanish stock exchange, in 1996, being the first European hotel company to be listed public.

From this point onwards, taking advantage of business opportunities, the company consolidated its international development in key regions, such as Europe and Latin America, increasing its portfolio globally. Currently, the group operates in 7 regions, namely Spain, EMEA, Mediterranean, America, Brazil, Cuba and Asia, all under the umbrella of 7 different brands – Gran Meliá, Paradisus, ME – premium segment - Innside, Meliá Hotels and Resorts – upscale segment - and TRYP and Sol – midscale segment - comprising a total of 376 hotels, and 79000 rooms.

Business Plan

Exhibit 2: Room distribution by model (2016)



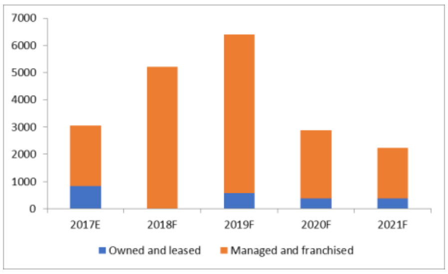
Source: Meliá

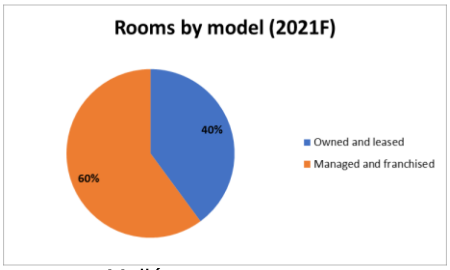
The lodging industry has evolved in 2011 in a global trend, in the wake of the financial crisis, towards a hybrid management model, favouring a low-intensity capital growth model. Although this shifting would make the companies that adopted this trend to have their profits growing steadier, mostly through fees obtained from managing the hotels, they would also be less exposed to macroeconomic cycles, mainly the negative ones, as companies become less affected to demand volatility compared to groups that operate under owned and leased hotels. Thus, Meliá developed four distinct systems for its operating activity, as it is explained below:

- **Ownership** – where both the ownership and the management of the property is in the hands of the company.
- **Lease** – where the company leases facilities to operate a hotel under one of its hotel brand names.
- **Management** – where the management of the hotel is the responsibility of the group, but the property is owned by a partner with whom the company has agreed conditions for its management services.
- **Franchise** – where the group cedes the use of its own brand names for a certain period to a partner so that it could operate the hotel under the brand name.

From an asset intensive through an asset "right" strategy

Exhibit 3: Future Pipeline and model distribution



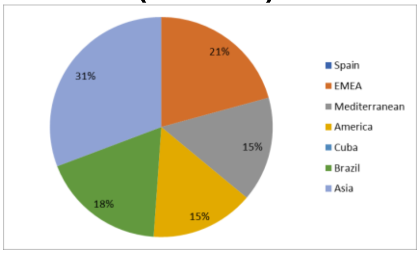


Source: Meliá

Following the transformation from a proprietary company, with hotels in management, to a management company with hotels in property, Meliá today has a portfolio of assets where low capital intensity models (management and franchise) represent 55% of rooms on the traditional models (owned and leased). In fact, of the 18 openings that occurred in 2016, 63% were under a management model, and to a lower extent, under a franchise model.

Furthermore, by analysing the future portfolio expansion pipeline of the group, the company plans to increase its portfolio by 22%, representing an increase of 71 hotels (17,183 rooms), of which approximately 90% would be under the management model and 10% under variable leases. Furthermore, following the company's expansion pipeline, by 2020 the company's portfolio will be constituted by 60% of hotels under the management/franchised model and 40% under the owned/leased model.

Exhibit 4: Pipeline by region (% of total)



Source: Meliá

Exhibit 5: Main JVs

Main JVs	Asset Location	Melia %
Adprotel Strand	EMEA	50%
Renasala	Mediterranean	30%
Evertmel Group	Mediterranean	49%
Altavista Hotelera	Spain	49%
Starmel Group	America	20%

Source: Meliá

Notwithstanding, the company has seen that in addition to its asset light strategy, based on management/franchised contracts, its hotel ownership strategy should be asset "right", i.e. still retaining the ownership of some core assets. The main factors that distinct which assets to retain should be based on the strategic importance for the group, as it could facilitate the signing of new management contracts, or the desire to reposition some assets to make them more attractive and take advantage of real estate cycles.

Furthermore, this reallocation of some non-core assets is being done by the group through joint-ventures (>300mn investment in books), as a way to minimize the risk and the amount of capital allocations, as the financial risk and return is shared with the associate partner. By 2016, Meliá had accounted in its Balance Sheet a EURmn 318 investment in JVs, of which 190mn in equity stakes and 128mn in shareholder loans. Therefore, the importance of these vehicles within the group's expansion should continue to be high in the future, as its main goals are 1) the benefits achieved in the underlying management contracts that Meliá retains; 2) the greater control obtained over the property management (often delegated by the financial partner to the group); and 3) the avoidance of the payment of large amounts to expand its portfolio through the traditional fully owned policy.

The typical financial partner is chosen according to the company's strategy for the specific asset, as well as its characteristics. Furthermore, two types of JVs can be highlighted, taking into consideration the contracts previously endorsed:

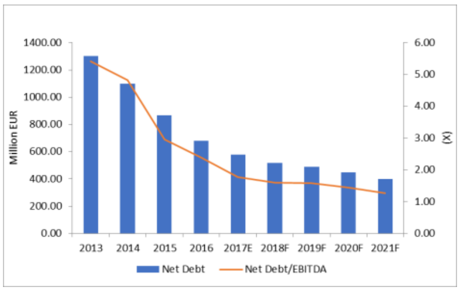
I. High risk, high return: typically formed with a private equity company. In this type of contract, the assets are acquired by the JV held by Meliá and the financial partner. The financial partner usually holds a passive role in the management of the property, which is normally delegated to Meliá.

II. Industrial: These agreements are made with an industrial partner allowing the structure to expand beyond the pure hotel product into a combined offer of complementary services. Indeed, Meliá's partnership with Producciones de Parques, where Meliá contributes with Sol Magalluf Park Collection and the latter with a thematic park is the most relevant partnership in this category.

This said, Meliá currently does not plan to expand its investment in JVs beyond the current level, thus expecting to finance growth with the reinvestment of the proceeds with loan repayments and potential asset sales.

Net Debt Evolution

Exhibit 6: Net Debt Evolution



Source: Meliá, Analyst forecasts

As the group was a traditional proprietary company, supporting its international expansion through the addition of new owned hotels, the debt position of historical years was considered high, as the net debt values of historical years suggest. However, by shifting its business model through an asset light model, sustaining its new openings almost all based on management/leased contracts, selling non-core assets, and through the conversion of previous convertible debentures, the group is delevereging its debt position. Indeed, the group expects to have its Net Debt/EBITDA levels to decrease, to reach a target below 2.0x Net Debt/EBITDA[2].

Shareholder structure

Exhibit 7: Meliá vs IBEX

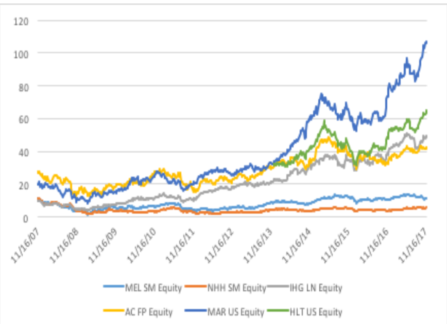
Source: Bloomberg

Meliá Hotels International (MEL) became listed on 1996, and it has ever since been a member of the IBEX Medium Cap Index. The shares started trading at EUR 6.89. In 2016, the company returned to the leading stock index in Spain, the IBEX 35, return that was made possible thanks to the positive performance of the company in recent years, and increased liquidity.

Looking over a 5-year horizon, Meliá Hotels International share price registered a compounded annual growth rate of 13.9%. Comparing with the respective indexes where the company is included, the IBEX 35 registered a 5.1% CAGR increase, whereas the IBEX Medium Caps Index registered an 11.4% CAGR.

Regarding the most significant company events for the share performance within the 5-year range, the company communicated in December 2014 about a capital increase for an amount of EURmn 2.85, through the issue of 14,276,271 newly-issued ordinary shares, worth EUR 0.2 of nominal value on date December 23, 2014. Last year, on the 25th April, the company informed about a capital increase, linked to the amortization of a convertible bond, for an import of 6,129,390.40 Euros through the issue of 30,646,952 newly-issued ordinary shares, worth EUR 0.20 of nominal value each one of them.

Exhibit 8: Share Price Evolution in EUR



Source: Bloomberg

As of December 2017, the company has 230 million shares outstanding, from which 48% free float. The shares are fully subscribed and paid up, constituting a unique single class and series. Furthermore, each ordinary share present or represented at the General Shareholders' meeting entitles the owner for one voting right.

[2] According to Meliá's 2014-2018 business plan

The shareholder base is comprised of both public and non-public shareholders. The latter includes both directors and other employees. The main shareholders are comprised by the Escarrer family, which currently owns 52.0% of the holding and Norges Bank, owning 2.95%.

The Sector

Global Macroeconomic Environment

2016 has witnessed a moderate global growth of 2.2%, the lowest level since the financial crisis of 2009. This deceleration of growth led to lower levels of investment, less international trade and increased levels of indebtedness in the world's economies. Complementing this fact, the low commodity prices had put additional pressure on traditional exporting countries and generated inflation below 1% in the developed countries.

The previous year was also a year where geopolitical conflicts and tensions persisted, increasing the volatility of the markets and generating economic instability. The Brexit referendum was just an example of the political uncertainties that lowered the growth expectations for the Euro area.

Exhibit 9: Real GDP growth (annual percent change)

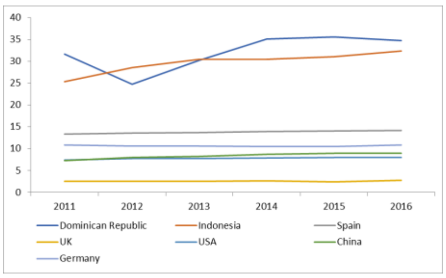
Source: IMF

For 2017, global forecasts expect the global economy to rise 2.7%, which will be the basis for a further increase of 2.9% in 2018. Furthermore, it is expected prices of raw materials to rise, having impact on the development of the economies of typically exporting countries, that could lead to a scenario of higher inflation and rising interest rates. The developing countries are expected to be the main drivers of this acceleration of global growth, with a growth rate of 4.6% vs a growth rate of 2.2%. Indeed, the region of Asia-Pacific will be the most contributor, with an expected economic growth of 6.0%, benefiting from strong domestic demand and expansive macroeconomic policies.

Global Tourism Highlights

The tourism sector has seen uninterrupted growth over time, despite some occasional shocks, demonstrating the sector's potential. In fact, international tourism arrivals have increased from 25 million globally in 1950 to 1,235 million in 2016.

Exhibit 10: Contribution of tourism on GDP (% of total)



Source: World Data Atlas

Indeed, the tourism segment currently represents 7% of the world's trade in goods and services, and has grown faster than overall world trade for the past five years. Currently it ranks third after chemicals and fuels categories, being ahead of the automotive industry and food. In many emerging economies (e.g. Indonesia, Dominican Republic) tourism is the top export category.

Over the past decades, tourism has experienced a large expansion and diversification to become one of the most representative and fastest-growing economic sectors in the world. In addition to the traditional favourite locals of Europe and North America, the sector witnessed the appearance of some emerging economies that have opened up and invested intensively in developing the tourism sector, being considered from that moment as new alternative destinations.

Exhibit 11: International arrivals growth rate (%)

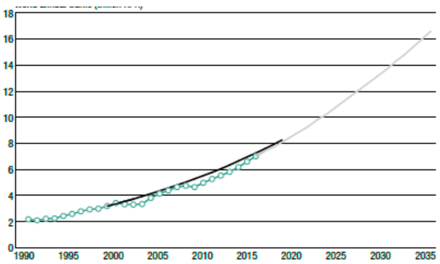
Growth Rate	Historical		Projection
	2015	2016	2017-2020
Spain	5.5%	10.3%	2.3%
EMEA	13.6%	3.5%	2.5%
Mediterranean	4.9%	1.3%	2.6%
America	5.2%	1.2%	2.2%
Cuba	17.5%	13.7%	2.4%
Brazil	-1.9%	4.3%	5.3%
Asia	5.4%	8.6%	5.7%

Source: UNWTO

▪ International Tourist Arrivals

International tourist arrivals (overnight visitors) reached a total of 1,235 million in 2016, representing an increase of 3.9% when compared to 2015. Indeed, 2016 marks the seventh consecutive year of sustained growth in international tourism, increasing by 4% or more every year following the global recession of 2009. Uninterrupted solid growth has not been recorded since the 1960s.

Exhibit 12: World Annual Traffic Forecast (trillion RPK)



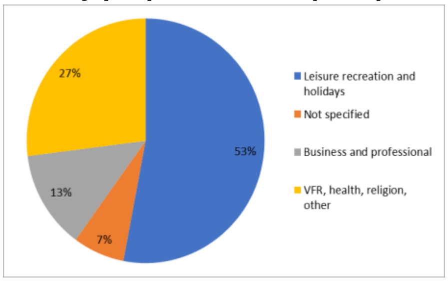
Source: IACO, Airbus GMF

In 2016, the demand for international tourism followed the positive trend of past years, with many destinations reporting sound results, while a few faced some challenges, mostly as a result of security threats and natural catastrophes. Thus, it was observed some redirection of tourism flows, though most destinations shared in the overall growth, mainly as a result of stronger travel demand, increased connectivity and more affordable air transportation prices.

The region of Asia-Pacific led this growth with a 9% increase in international arrivals, followed by Africa, with an 8% increase and the Americas, with 3% increase. Europe, the world's most visited region showed an increase of 2%.

Regarding the purpose of visit, leisure, recreation and holidays continue to be the dominant segment, accounting for just over half of all international tourism arrivals in 2016.

Exhibit 13: Inbound tourism by purpose of visit (2016)

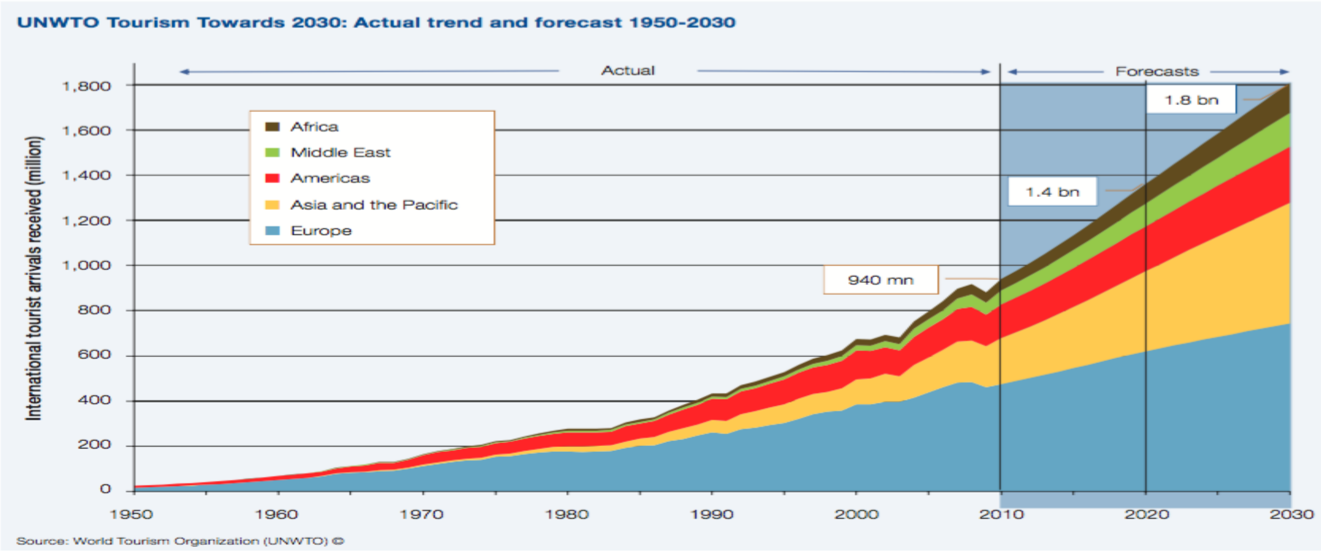


Source: UNWTO

Considering a long term outlook, international tourist arrivals worldwide are forecasted to increase by 3% annually, reaching the mark of 1.8 billion by 2030. The rhythm is not expected to be equal among economies, being emerging destinations expected to increase 4.4% a year, twice the rate of those in advanced economies (+2.2% a year). As a result, the arrivals in emerging markets are expected to exceed those in developed economies before 2020. By 2030, 57% of international arrivals will be in emerging economy destinations – versus 30% in 1980 – and 43% in advanced economy destinations – versus 70% in 1980.

When analysing each region, the strongest growth is expected to occur in Asia-Pacific, where arrivals are expected to rise 4.9% per year. As for Europe and the

Americas, both regions are expected to grow more slowly (2.5% and 2.2% growth, respectively).



Regional Outlook

Spain – Enjoying the favourable macro environment

- **Macroeconomic environment**

Exhibit 14: Spanish GDP growth (annual percent change)

Source: IMF

Economic growth remained robust in 2016, and it is expected to continue in order to reach a 3.1% real GDP growth in 2017, according to the latest IMF World Economic Outlook of October 2017. This increase will be the third consecutive one, outpacing most Euro area countries. In fact, a more balanced growth pattern than in the pre-crisis period is supporting this expansion, with both domestic and external demand contributing to the registered growth. For the subsequent years, growth is projected to continue, although at a slower pace.

The recent Catalonian tensions could lower the consumer and business confidence. However, as at this moment it seems that the government has controlled the situation, we should not expect a very significant impact from these events.

- **Sector Overview**

"Spain is enjoying a surge in tourism as fears over terrorism drive wary travellers away from destinations in Turkey and North Africa and back to former favourites in southern Europe."

Source: Financial Times

Spain is currently the third most visited country in the world. Besides the country's western European location and Mediterranean weather, there are two other important factors that are making Spain an even more appealing destination both to visitors and to lodging investors: the fact that the country is considered a safe destination and the strong economic recovery the country is facing. Currently, the tourism sector contributes 16% to the Spanish GDP, providing 11% of jobs.

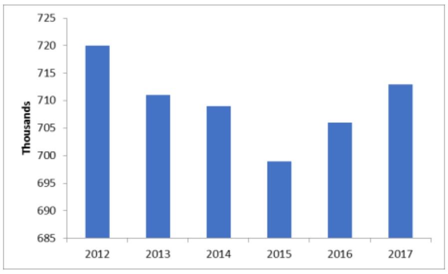
"Summer 2016 bookings to Spain's Balearic Islands were up 14 per cent compared with last year while those to the Canaries were up 23 per cent (...) Turkey suffered its worst drop in visitor numbers since 1999, with arrivals falling 28 per cent to 1.75m."

Source: Financial Times

"Spain was visited by 287,873 Chinese tourists in 2014, an increase of 14% over the previous year."

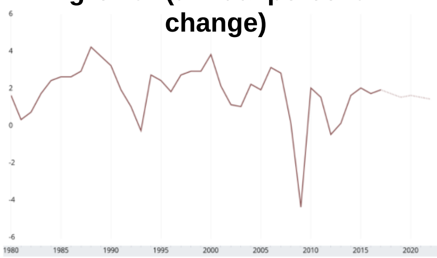
Source: UAB - Research

Exhibit 15: Hotel supply in Spain



Source: Euromonitor

Exhibit 16: Europe GDP growth (annual percent change)



Source: IMF

In fact, Spain has increasing its demand as a tourism destination. From 2013 to 2016, The Average Daily Rate (ADR) grew on average by 14%. In addition, the occupancy rate has grown significantly from 57% to 66%. Also, as a result of some security concerns that started to appear in other typical European countries and other typical leisure destinations of North Africa, we are currently witnessing a shift from these places to the typically leisure destinations of Southern Spain and the Spanish Islands. According to the World Travel and Tourism Council (WTTC), by the year end of 2016, 70 million tourists visited the country, and these numbers are expected to increase an additional 2.7% annual increase from 2017 to 2020.

On the other hand, Spain is also witnessing a significant growth influx of travellers from emerging markets, such as China, Brazil and Mexico. This means that in the future, the lodging industry will have to be ready to answer the requirements of these increased inflows.

All in all, there are clear long-term growth opportunities for the industry to capitalise on. However, there are also multiple challenges: the sector needs to adapt to shifting demand going forward; greater coordination is required with other economic activity sectors; and, in order to prioritise investment in infrastructure. Thus, it is expected a strengthening of the Spanish lodging industry, in order to answer to the increase in international arrivals.

Europe – Mixed results across destinations

- ### Macroeconomic environment

The region of Europe has since 2014 started to recover from the years of economic stabilization that resulted from the 2009 financial crisis. Indeed, since 2014, the region has always registered real GDP growth above 1.0%. According to the IMF World Economic Outlook of October, 2017 Europe is expected to reach a 1.8% GDP growth in 2017, with the peripheral economies growing faster than the core economies of Germany, France and Italy.

Regarding inflation, it is expected that Europe would register its annual inflation rate above 1.0% starting in 2017. Rising inflation, as well as an appreciation of the Dollar against the Euro could keep domestic demand for holidays within Europe.

- ### Sector overview

2016 was a year of mixed feelings for the hotel sector in Europe, as safety and security concerns impacted some destinations. However, in the year end, tourism proved to be resilient, as 12 million more tourists visited the continent than in the record breaking year of 2015, and more than 2.8 billion nights were spent in tourism accommodation in Europe. Some Mediterranean destinations flourished. Overall, in 2016 the European hotel industry saw a RevPAR[3] increase of 2.1%, according to data from STR Global.

Regarding supply, as the industry is already in a consolidated phase, it is expected to continue to see relatively low levels of new accommodation supply growth, despite some development hotspots such as Berlin and London. The increase in supply in 2016 was just 0.9%, according to data from STR Global, whereas the historical average annual increase over the past decade had been 1%. In fact, some cities have already introduced restrictive legislation to control new hotel development.

"Much like Barcelona, the local government of Amsterdam has implemented a policy that limits development in the city centre."

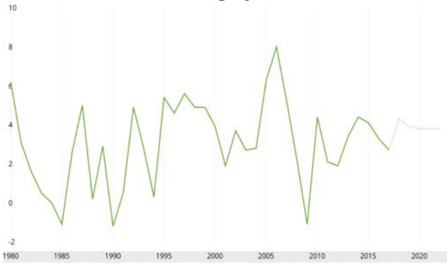
Source: PwC

Central America and the Caribbean

▪ Macroeconomic environment

In Central America, the recent oil price dynamics, uncertainty about future US migration and travel policies, and higher external demand have helped to slow growth from 2.4% in 2016 to 1.8% during the first half of 2017. Regarding inflation, it has accelerated in the beginning of 2017 in most of the countries of this region to reach 3.0% in the area as a whole, as a consequence of the recovering oil and food prices.

Exhibit 17: Caribbean GDP growth (annual percent change)



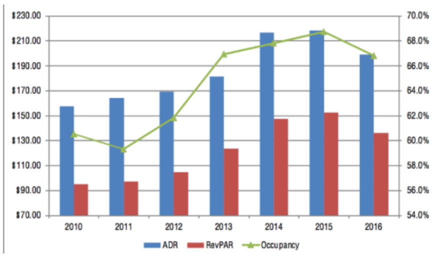
Source: IMF

The economic forecasts for the Caribbean region are improving in an overall perspective. The projected growth of these tourism-dependent economies for 2017-18 is to be set into approximately 3.0%, up from 2.0% in 2016. There is, however, substantial variation across countries within this geographic area.

▪ Sector overview

2017 is being a challenging year for the lodging sector of this region, as a consequence of the unforeseen impacts that the natural disasters have been originating. In fact, the Hurricanes Harvey and Irma have affected a lot of the countries and hotels of this region. Indeed, the industry has seen thousands of hotel booking cancellations as a result of the hurricane concerns.

Exhibit 18: Caribbean lodging overview



Source: STR Global

The oversupply of hotels in Dominican Republic, explained by the 5,000 new hotel rooms opened in 2016, as well as the health concerns related to the zika virus, will likely be a challenge for the lodging industry in this country, as demand is not responding to the excess supply that Dominican Republic is currently facing.

[3] RevPAR is calculated by dividing hotel room revenue by total number of room nights available to guests for a given period

Regarding Cuba, the country saw a large increase in 2016, following on relaxation of the travel rules made by the Obama administration. However, a decrease is expected this year, now that the Trump administration has reinstituted portions of the previous travel bans.

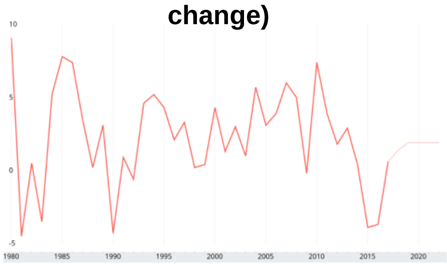
To sum up, indications from data reported by STR Global are that the three major metrics (Average Daily Rate, Occupancy Rate, and RevPAR) are and will continue flat for 2017, following slight declines in 2016.

Brazil – Time for recovering

- **Macroeconomic environment**

While Brazil's infrastructure was significantly enhanced to help support main world events, such as the 2014 World Cup and the 2016 Olympic Games, the country faced significant headwinds as a result of economic and political challenges currently facing. Indeed, downward pressure on commodities pricing has resulted in negative gross domestic product (GDP) growth in both 2015 (-3.8%) and 2016 (-3.6%). Also, high levels of inflation in both 2015 (+9.0%) and 2016 (+8.7%), and associated increases in wages and energy costs have contributed to the contraction of the macroeconomic environment of this country.

Exhibit 19: Brazilian GDP growth (annual percent change)



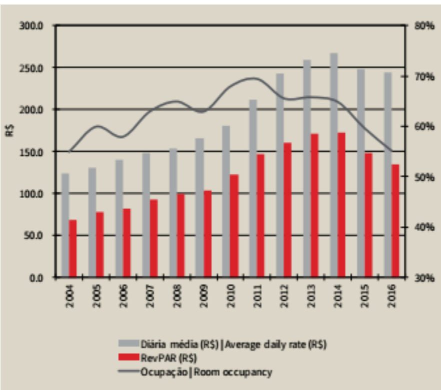
Source: IMF

Regarding future years, the Brazilian government is focussing on decreasing the inflationary pressures, by decreasing interest rates. Also, to fight back the contraction of the GDP, the government is focused on appreciating the Brazilian Real. Furthermore, the country is expected to come back to growth in 2017, increasing its real GDP growth to 0.7%, number that it is expected to increase during the following years to reach a 2.0% real GDP growth in 2020.

- **Sector Overview**

The economic recession, coupled with major increases in rooms supply, has severely affected the performance of the country's lodging industry. Looking for the numbers, in 2016 the occupancy rate of city hotels declined by more than 7.0% in relation to the previous year, reaching an average of 55%. Moreover, the country's global RevPAR fell by approximately 9.0% compared to 2015. However, this decline was significantly lower compared to 2015, which saw a RevPAR decrease of almost 15%. These metrics pointed to the bottoming of the lodging market.

Exhibit 20: Brazilian's lodging overview



Source: JLL

Nonetheless, the incipient economic recovery (+0.7% expected economic growth in 2017) and the enhanced attractiveness of the country as a group and leisure destination is driving the Brazilian's lodging sector to a turning point that should be manifested by growing demand and improved lodging fundamentals at year end and into 2018.

The country has seen a record addition in supply in previous years, as a result of the main sport events that Brazil hosted. Furthermore, new additions are expected although at a more rational opportunity. This would for certain result in a decrease in prices of accommodation, as the current demand is not sufficient to meet the oversupply, represented by the decreases in the Average Daily Rate (ADR) that will attract an increase in demand that had been compressed out of the market due to previously very high room rates.

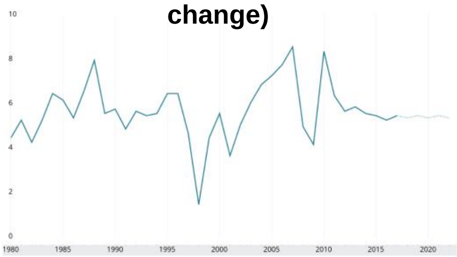
To sum up, for the upcoming years it is expected that 2017 will mark the beginning of a cycle of growth in hotel supply, marked by more rational hotel investments and helped by the continuing macroeconomic stabilization in the country.

Asia and the Pacific – fastest growing region in 2016

- **Macroeconomic environment**

Asia is currently the world's largest region in economic output, in US dollar terms, after its combined gross domestic product (GDP) reached USD 25.8 trillion in 2016, surpassing that of the Americas – USD 25.2 trillion – for the first time in historical series.

Exhibit 21: Asia-Pacific GDP growth (annual percent change)



Source: IMF

Indeed, between 2000 and 2016, Asia was the region that experienced the fastest economic growth across world regions, largely driven by the Chinese and Indian economies. The region's GDP grew above 5.0% almost every year, growing over 7.0% in 2005 and 2006, and over 8.0% in 2007 and 2010.

Income levels in Asia and the Pacific have surged since the past decade, with the region's per capita GDP practically doubling, from USD 3,170 in 2005 to USD 6,240 in 2016. This expansion has been fuelled by increasing market liberalization, large infrastructure development and the rising of a middle class.

- **International Tourist Arrivals**

Asia and the Pacific is currently the second most visited region in the world, right after Europe and has been witnessing the fastest growth in recent years. In 2016, the region enjoyed a 9% increase in international arrivals, the highest across world regions, to reach 308 million international tourists.

Between 2005 and 2016 Asia outperformed all world regions in terms of growth, with overnight visitors increasing an average of 7% per year, compared to the world average of 4%.

While inbound tourism has been a dominant force, the outbound sector should not be ignored. Indeed, driven by the strong economic environment of the region, a strong and vibrant middle-class has emerged with disposable income to travel.

Along with advances in the region such as paid vacations, more holidays especially in the form of festive breaks and religious celebrations, travel and tourism has been the main beneficiary of the socio-economic and the socio-cultural progress seen in this region.

China is the largest economy in Asia and the Pacific and the second largest in the world. As a result of its remarkable economic growth and combining with the fact that it is the country with the largest population in the world, international travel from China has boomed in the last decade. In fact, since 2012 China occupies the number 1 rank as the leading outbound market for many destinations in this region. Indeed, a notable feature of tourism in Asia and the Pacific region is that 80% of the traffic is intra-regional. This dominant regional influence has been prevalent since 2006. As for inter-regional tourism for this area, Europe is the largest source, accounting for 10% of all arrivals.

- **Sector Overview**

Meliá concentrates its current operations and further expansion pipeline in two main countries within this region – Thailand and Indonesia.

Thailand increased its international visitors by 7.5%, y-o-y, as a result of its resurgence in 2015 from the past year's political unrest. The passing of His Majesty King Nhumibol Adulyadej resulted in a decrease in overnight visitors, fact that was quickly offset and returned to normal activity. For upcoming years, record arrivals are expected to appear, according to airport statistics that already indicate growth. In fact, the number of visitors in Thailand is expected to reach more than 40 million by 2020.

Exhibit 22: Hotel KPIs (2017)

	Occupancy Rate (%)	ADR (USD)	RevPAR (USD)
Bali	66.4	146	97
Jakarta	53.8	166	89
Bangkok	86.4	99	86
Phuket	87.9	147	129

Source: JLL

Regarding the supply of accommodation, according to the World Tourism Highlights of 2017, performed by the UNWTO, it is expected to be observed an increase, in order to reach the number of 2,876 new rooms in 2017 for the city of Bangkok, for instance. As for the demand side, Mainland China remains the biggest source market to this country.

To sum up, Thailand will continue to see strong growth in visitor arrivals with ongoing airport expansions expected to increase capacity from 45 to 60 million passengers annually. Higher airport capacities are then expected to translate to increases in lodging demand and absorb the oncoming hikes in room supply.

Regarding **Indonesia,** the Bali Provincial Tourism Agency is targeting approximately 40% of the targeted 15 million foreign tourist arrivals to the country in 2017. This increase in arrivals can be attributed to the facilitation of visa waivers back in 2015, as well as to the improvements in air connectivity to key source markets.

Regarding the supply of rooms, it is expected to be added 3,892 rooms in Bali for the year of 2017, which compared to the 1,737 rooms opened in 2016 represents an intensification of the expansion of supply in this country. As for the demand, Mainland China is historically the main source market, being expected to continue this trend. Other sources, such as USA, Europe and Brazil are increasing its representation.

All in all, looking forward, recent improvements in air connectivity, including new routes, and other policies will continue to boost the expansion of the lodging industry in this country.

Competition

Meliá's competition is extremely diverse among its business segments of business and leisure. Also, its competitors vary according to the region. The group currently has 58% of its portfolio constituted by resorts being the rest of the portfolio city hotels. Furthermore, the following competitors were chosen as they are hotel chains that operate in the same regions and in the same business segment as Meliá.

NH Hotel Group SA – Founded in 1978, and headquartered in Madrid, Spain, this group operates in 30 markets, being divided into five business units. NH Hotels operates its properties using three models, such as owned, leased and managed. However, its operational activity mainly depends on the proprietary units. Its portfolio is currently structured into 4 different brands – The NH Collection (premium), Nhow Hotels (upscale), Hesperia Resorts (upscale), and NH Hotels (midscale).

Regarding the operational development of the group, NH Hotels undertook a 5-year strategic plan between 2014 and 2018. The main objective of this plan was to improve the financial structure of the company, while at the same time improving the operational efficiency.

Looking for the operational breakdown of the group, the majority of its 2016 revenues came from the regions of Central Europe and Spain, with 27% and 25% of the total respectively.

InterContinental Hotels Group – Founded in 1946, and headquartered in London, UK, InterContinental is nowadays one of the biggest and most famous hotel chains worldwide, holding operations in more than 100 countries, under 12 different brands, each one of them operating in a particular business segment, thus having its own price and type of accommodation. The group is quoted in the London Stock Exchange, with a current market capitalization of EURbn 9.41.

Regarding the operational activity of IHG, 58% of the group's revenues came from the regions of the Americas, where its portfolio concentrates the most (64% of total rooms), followed by Asia (14%) and Europe (13%).

Looking over the group's expansion pipeline America is the region where the expansion will concentrate the most – 44% of total expansion pipeline – followed by the region of Asia-Pacific – 31% of total expansion pipeline.

Accor SA – Founded in France in 1967, Accor operates under 20 well-known brands, offering hotel accommodation services from more luxurious to less sophisticated segments. Nowadays, it is present in 95 countries with 4200 hotels. Accor is quoted in the Euronext Paris stock exchange, with a current market capitalization of EURbn 12.26. In 2016, it comprised revenues of EURmn 5,631.

In regards with the future portfolio expansion strategy, Accor intends to mostly expand its operations to the region of Asia and the Pacific, weighting 47% of the group's total expansion pipeline.

Marriott International – Marriott Hotels is a multinational hotel company present in around 110 countries, with a current market capitalization of EURbn 38.85. In 2016, the group completed the acquisition of Starwood Hotels and Resorts Worldwide, which expanded its presence around the world, offering the largest and most compelling range of brands and properties in the hospitality sector.

2016 was also the year where the group experienced an expansion record growth. For 2017, the group expects to increase its room capacity by net 7%.

The group is planning a balanced expansion strategy, spreading through the regions where the company already operates.

Hilton Worldwide Hotels – Hilton Hotels was created in 1925, with the first hotel opening in Texas, USA. Nowadays, Hilton is considered one of the biggest hotel chains in the world with 14 different brands and more than 47000 hotels operating in more than 100 countries. Currently, it has a market capitalization of EURbn 20.76.

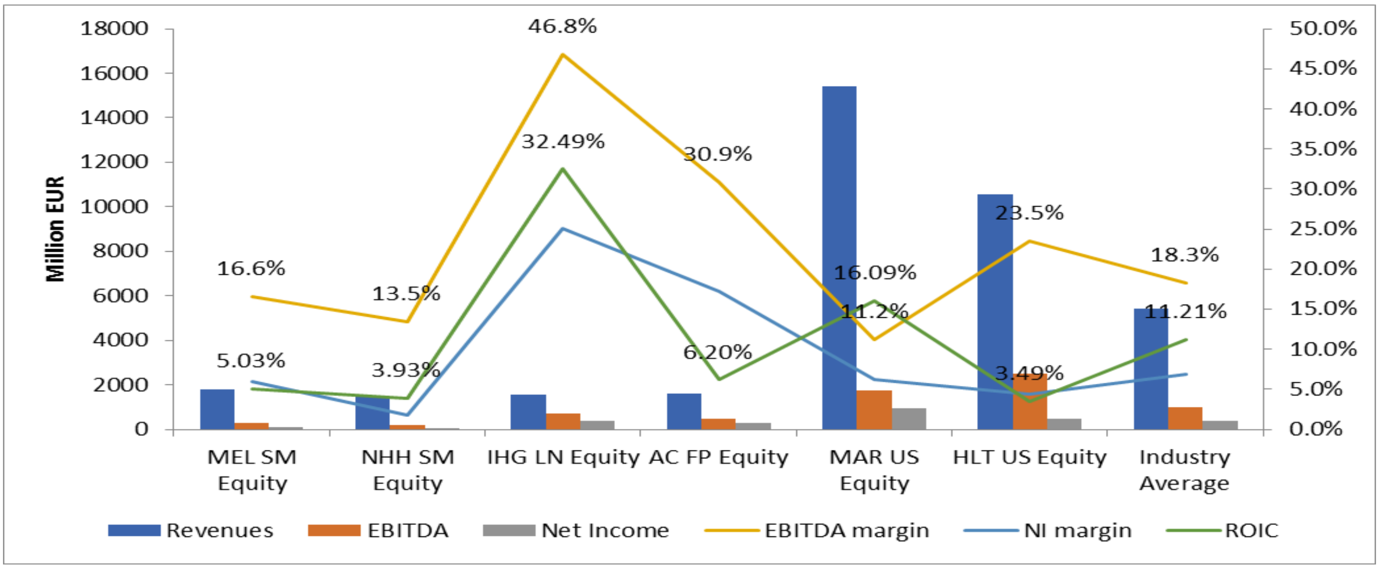
Looking for the operational activity of the group, the majority of its revenues comes from the United States and Asia, accounting for 71% and 10% of the total, respectively.

Concerning the group's portfolio expansion pipeline, it is expected to be concentrated mostly in the region of the Americas, representing half of the total expansion strategy.

To sum up, Meliá Hotels International faces competition from several international hotel chains. However, as its portfolio is mostly located in the region of the Americas and Spain, and as the majority of its clients is Spanish, weighting 17% of total customers, and adding to the fact that the group is a well-recognised brand in the industry, we believe that customers will tend to look always at the group as a valid alternative, and more specifically, Spanish customers will tend to choose a national company when available.

By performing a quick analysis of last year's operational activity of each of the competitors, represented by the revenues, the EBITDA margin, Net income margin, and the Return on Invested Capital (ROIC), several conclusions can be taken out. Indeed, looking at the companies' EBITDA margins, one can see that InterContinental is the group that presents the highest margin (46.7%). However, considering the revenues of InterContinental, they do not differ much from the industry average. This shows the great operational management that the group is taking. Comparing Meliá to the remaining peers, the EBITDA margin and the Net Income margin does not differ much. Comparing to the industry average, the same conclusions can be taken out.

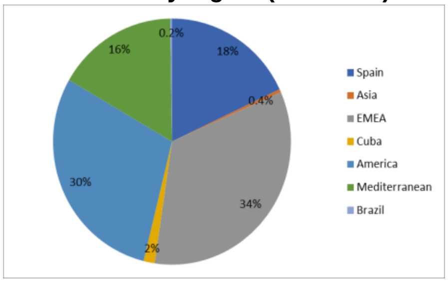
Conducting now a comparison taking into consideration the respective companies' ROIC, we can conclude that the group's that present the highest ROIC are the ones that are more intensive in managed/franchised hotels (asset light strategy). In fact, InterContinental Group presents the highest ROIC (32.49%), and currently has 97% of its portfolio either under a management/franchising scheme[4]. Looking at Meliá, we can see that it presents a ROIC lower to the industry average, signalling that comparing to the industry, the group is still not so capital light. However, looking at the respective expansion pipeline, we should expect an increase of the company's ROIC.



[4] Source: InterContinental Group Investor Relations

Valuation

Exhibit 23: 2016 Operating income by region (% of total)



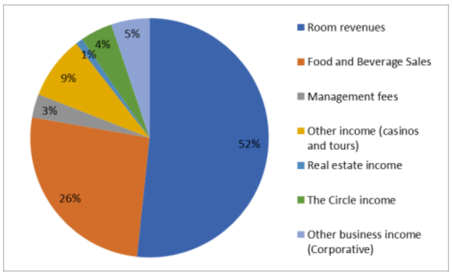
Source: Meliá

Meliá's Performance

By analysing the group's EBITDA margins for the last three years, one can conclude that the company is improving its margin, mainly by increasing its revenues more than it its costs are increasing. Moreover, uninterrupted increases in RevPAR in a global perspective are contributing to the increase in revenues, mainly explained by increases in occupancy rates and, more importantly, by increases in prices, reflected by the Average Rate Room (ARR) [5].

In fact, looking at historical figures, the region of the Americas is getting more and more importance to the group's activity with room revenues accounting for 182 and 196 million euros in 2015 and 2016, respectively, only overpassed by the region of EMEA, where the company concentrates its portfolio the most. Indeed, in 2016, the region of the Americas accounted for 30% of the group's gross operating income.

Exhibit 24: 2016 Operating income by operating segment (% of total)



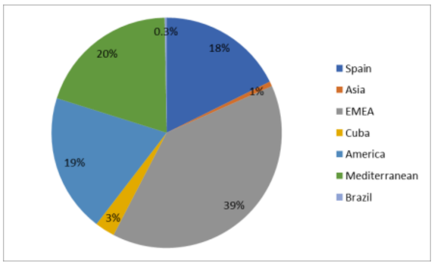
Source: Meliá

Revenue drivers

By segmenting the overall operating income of the group, it is possible to make a better analysis of each revenue driver and thus forecast revenues in a more accurate way.

Moreover, the group's operating income is composed by the following items: revenues obtained by the **room sales**, including sales of rooms of the owned and leased hotels and also sales of food and beverages; **management fees**, comprised by third party fees from the franchised and managed hotels; **real estate income,** which comprises capital gains from certain asset sales and income from investment properties; income from the vacation club, **The Circle**, and **other income**, such as the one that results from the casino activities and tour operations, and revenues obtained from corporative activities.

Exhibit 25: 2021F Operating income by region (% of total)



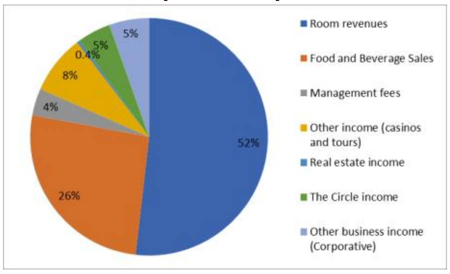
Source: Analyst Forecasts

Regarding income obtained from the **sales of rooms**, two main drivers are determinant: The RevPAR and the number of owned and leased rooms of each region. As we expect the number of international tourism flows to increase in the future, as explained above in the global sector overview and in more detail in each regional sector analysis, we forecast that the evolution of the occupancy rates will be the main driver that will lead to increase the global RevPAR of the

[5] ARR represents hotel room revenue divided by total number of room nights sold for a given period. It measures average room price attained by a hotel

group in future years, boosted by the international tourism arrivals expected growth. We expect the trend of uninterrupted growth of the RevPAR to continue in future years. We expect prices to increase, although mainly as a result of inflationary pressures, reflected in the higher future ARR values.

Exhibit 26: 2021F Operating income by operating segment (% of total)



Source: Analyst Forecasts

Furthermore, we highlight the growth of 19% of room sales in the Mediterranean region in 2017E, mainly explained by the high values of projected occupancy rates. Indeed, in 2021F the Mediterranean region is expected to be the second region that contributes the most for the group's operating income (20% share).

As for the region of the EMEA, we expect a sustained growth, in line with the forecasts made previously in the macroeconomic sector for the lodging sector in this region. Indeed, EMEA is predicted to continue to be the region that contributes the most to Meliá's operating income (39% share).

As for the region of the Americas, the abovementioned outlook for this region explains the almost flat growth in room sales in this region for the year of 2017E.

Regarding food and beverage sales, we expect a similar growth as the one from room sales.

Occupancy Rates by Region	2015	2016	2017E	2018F	2019F	2020F	2021F
Spain	67.0%	67.5%	68.3%	69.1%	69.9%	70.7%	71.5%
EMEA	72.8%	71.9%	72.8%	73.7%	74.6%	75.6%	76.5%
Mediterranean	72.4%	79.1%	80.1%	81.2%	82.2%	83.3%	84.4%
America	70.8%	69.3%	70.1%	70.8%	71.6%	72.4%	73.2%
Total	70.8%	71.6%	73.2%	74.1%	75.0%	75.9%	76.8%

ARR by Region	2015	2016	2017E	2018F	2019F	2020F	2021F
Spain	80.30	87.80	89.52	90.84	92.34	93.86	95.54
EMEA	144.60	151.00	153.53	156.12	159.03	162.05	165.20
Mediterranean	72.30	85.30	86.43	87.61	89.03	90.57	92.22
America	105.20	120.50	118.00	120.91	124.07	127.17	130.29
Total	105.20	112.30	112.45	114.40	116.88	119.33	121.88

RevPAR growth (%)	2016	2017E	2018F	2019F	2020F	2021F
Spain	10.2%	3.1%	2.6%	2.8%	2.8%	3.0%
EMEA	3.1%	2.9%	3.0%	3.1%	3.2%	3.2%
Mediterranean	29.1%	2.6%	2.7%	2.9%	3.1%	3.1%
America	12.4%	-1.1%	3.6%	3.7%	3.6%	3.6%
TOTAL	8.2%	1.9%	3.0%	3.4%	3.3%	3.4%

Considering revenues driven from the **management model** - the third party fees – they are dependent of a fixed portion and a variable portion that depends on the gross operating profit of each managed/franchised hotel. Furthermore, as we do not forecast any material changes in the fixed component, the growth of this component will depend only on the variable part.

In this respect, and regarding the urban region of Spain, and EMEA, as the company already has a solid reputation and position, it is forecasted that growth remains, although at a slow pace. Considering the Mediterranean, as the tourism sector is witnessing an increasing shift in tourism flows from traditional leisure destinations that were affected by security threats to this area, we expect a strong growth in 2017 (+10.0%), followed by slower growth in subsequent years.

Taking into consideration the region of the Americas, and the significant new rooms that this region will have in the future, the third party fees from this region are expected to increase through time. On the other hand, in Cuba, as the year of 2017 is linked to some natural disasters that affected this region, and complemented by the setback of previous tourism visa developments made by the Obama administration, we anticipate a decrease in income in this region for the short-term, being this decrease offset by the projected large increases in the subsequent years (+20.0% in 2018F), as a result of the resignation of Mr. Raul Castro, and expected liberalisation of the country. Considering Brazil, and taking into consideration the conclusions taken above in the macroeconomic and sector overview for this country, where the fight of corruption, the fight for inflation pressures and the turning point in the economic activity are the key takeaways, we expect that the country starts to witness increases in third party fees, at a faster pace in 2017 and 2018, being then slower in the following years.

Finally, regarding the Asia and the Pacific region, taking into consideration the massive expansion the group is expected to do and the positive outlook in tourism arrivals mentioned in the sector analysis presented above in this report, significant increases are projected in third party fees coming from hotels within this geographic area.

Management fees growth (%)	**2016**	**2017E**	**2018F**	**2019F**	**2020F**	**2021F**
Spain (Urban)	-18.3%	5.0%	1.0%	1.0%	1.0%	1.0%
EMEA	18.5%	5.0%	15.0%	10.0%	10.0%	10.0%
Mediterranean	-11.9%	10.0%	7.0%	5.0%	5.0%	5.0%
America	20.0%	10.0%	10.0%	15.0%	20.0%	5.0%
Cuba	30.8%	-5.0%	20.0%	10.0%	5.0%	5.0%
Brazil	-43.9%	20.0%	10.0%	5.0%	5.0%	5.0%
Asia	18.8%	15.0%	20.0%	25.0%	20.0%	10.0%
TOTAL	5.5%	3.3%	13.5%	9.4%	7.5%	5.5%

Considering the company's vacation club, **The Circle**, its business model has faced an innovation shift in 2016, transitioning from "Club Meliá" to "The Circle", changing its fundamentals to a more customer oriented service. Moreover, as a consequence of this change, the group saw a large decrease in revenues in 2016 (-21.0%). However, we anticipate 2017 to be the turning point, being mainly supported by the increase of 28.0% of new memberships as of 3Q17, with revenues still decreasing, but at a slower pace, followed by increases in future years. In fact, we still expect a decrease of 10% in the Circle revenues, followed by an increase of 20.0% in 2017E, and slower increases in the following years.

Regarding **real estate income**, which represents income from investment properties and capital gains from these asset sales, Meliá has up to this day a portfolio of apartments located in Spain and a shopping mall located in Dominican Republic that currently are considered as being core assets. Thus, no asset sales are expected in the future, being the income driven from this segment only from income originated by these properties. Moreover, the yield of the portfolio of apartments located in Spain are expected to remain constant, yielding a 6.5%[6] annual return, the same as for the shopping mall located in the Dominican Republic, yielding a 7.5%[7] annual return.

(values in EURmn)	2015	2016	2017E	2018F	2019F	2020F	2021F
Room revenues	848	932	1009	1041	1087	1131	1177
(% growth)		10%	8%	3%	4%	4%	4%
Food and Beverage Sales	457	470	510	527	549	571	593
(% growth)		3%	9%	3%	4%	4%	4%
Management fees	49	57	59	67	74	79	83
(% growth)		17%	4%	13%	9%	7%	5%
Other income (casinos and tours)	129	154	164	169	175	182	189
(% growth)		19%	7%	3%	4%	4%	4%
Real estate income	70	18	9	9	9	9	9
(% growth)		-74%	-48%	0%	0%	0%	0%
The Circle income	99	78	71	85	93	98	103
(% growth)		-21%	-10%	20%	10%	5%	5%
Other business income (Corporative)	87	94	111	114	119	123	128
(% growth)		8%	18%	3%	4%	4%	4%
Operating income	1738	1802	1920	2000	2094	2182	2272
(% growth)		4%	7%	4%	5%	4%	4%

Cost Structure

Since the revenues of the group come mostly from the hotel business activity, comprised by the sale of rooms in owned and leased hotels, and the correspondent sale of food and beverages, the cost of goods sold (COGS) are expected to remain constant as a percentage of room sales, considering its past behaviour, representing 13% of room sales.

Moreover, the most representative item of the cost structure of Meliá is related to staff costs, representing, on average, approximately 30% of each year's operating income. In order to reach a sustained projection of the staff costs, and assuming the average workforce by region, presented in the company last year's annual report, the average cost per employee, as well as the average employee workforce per room was computed for each region, for the year of 2016. Although the latter was assumed to be kept constant, the first cost driver was updated

Exhibit 27: Staff Costs Value Drivers

Average Workforce by region	2016	(%)
Spain	10824	24%
EMEA	4288	10%
America	13116	29%
Cuba	12582	28%
Asia	3954	9%
Total	44764	100%

Average Employee Workforce per room	2016
Spain	0,74
EMEA	0,34
America	1,43
Cuba	1,03
Asia	1,05

Source: Analyst Forecasts

[6] Apartments valued at 76.8 million Eur, according to last JLL asset valuation
[7] Shopping mall valued at 59.0 million Eur, according to last JLL asset valuation

each year, considering the inflation projections for each region for each year, based on the World Economic Outlook of October 2017, developed by the IMF.

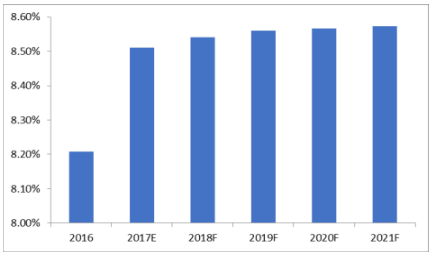
(values in EURmn)	2015	2016	2017E	2018F	2019F	2020F	2021F
Cost of Sales (COGS)	-215	-223	-240	-250	-262	-273	-284
(% operating income)	12%	12%	13%	13%	13%	13%	13%
Staff Costs	-463	-490	-512	-553	-604	-642	-680
(% operating income)	27%	27%	27%	28%	29%	29%	30%
Other Costs	-623	-640	-666	-694	-727	-757	-789
(% operating income)	36%	36%	35%	35%	35%	35%	35%
Leases	-144	-164	-174	-182	-190	-198	-206
(% operating income)	8%	9%	9%	9%	9%	9%	9%
Operating costs	-1444	-1516	-1593	-1678	-1783	-1870	-1958
(% operating income)	83%	84%	83%	84%	85%	86%	86%

Regarding the analysis of the projected EBITDA margins, one can conclude that it increases significantly in 2017E from 15.8% to 17.0%. This is a result of the improved operational efficiency resulted by the increase in revenues – mainly in room sales revenues – that more than compensated the increase in costs. On the other hand, in future years, the increase in costs – mainly the staff costs - more than offsets the increase in revenues, which will lead to slight decreases in the margin.

	2015	2016	2017E	2018F	2019F	2020F	2021F
Operating Income	1738	1802	1920	2000	2094	2182	2272
Operating Costs	-1445	-1516	-1594	-1679	-1784	-1871	-1959
EBITDA	293	286	326	321	311	311	313
EBIT	152	132	159	184	187	193	198
Operating Result from sales	71	77	113	132	134	139	144
EBITDA margin	16,9%	15,8%	17,0%	16,0%	14,8%	14,2%	13,8%
EBIT margin	8,7%	7,3%	8,3%	9,2%	8,9%	8,8%	8,7%

Net Working Capital and CAPEX

Exhibit 28: NWC (% of total sales)



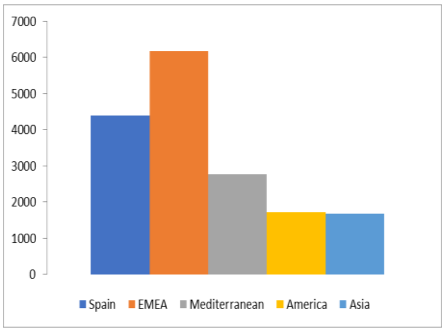
Source: Analyst Forecasts

Inventories are mainly comprised by stock of food and beverages. In fact, looking for historical numbers, inventories have been a constant proportion of food and beverage revenues. As such, we do not anticipate material changes in subsequent years. On the other hand, a method of past days' receivables and payables ratios was applied to compute the other accounts for receivables and payables, respectively.

Regarding capital expenditures, and as referred in sections above, the company is through a mechanism of passing form capital intensive to asset light. This turnover is confirmed by the future expansion pipeline, from which 90% of room additions will be under a management/franchised model. This expansion will thus enable the reinforcement of its position in selected markets with limited capital commitments and sharing the operational risks.

In addition, the group is only proprietary of the owned and leased hotels, as the managed hotels have their own owners, being Meliá only responsible for guaranteeing the operational part. Thus, the managed and franchised hotels do not count for the calculation of the group's capital expenditures.

Exhibit 29: Price per square metre (2016)



Source: Global Property Guide

As the countries where Meliá plans to open new hotels are extremely different, the costs of building them are also very different from each other. To reach the forecasted value of the tangible fixed assets, the following key drivers were taken into consideration: the average size of each room – 25m^2 - the number of owned and leased rooms of each region, and the price per square metre for each region. We considered the price per square metre to be the price for the largest cities of each country, as, even though prices in major cities usually tend to be the highest among a country, it is expected that Meliá wishes to open the new facilities in these places, as they are the ones where tourism concentrates the most.

We do not expect changes in the intangible fixed assets through time, as no relevant information regarding this item was obtained.

Cost of Capital

Exhibit 30: WACC summary table

Results	
Risk Free	0,47%
Market Risk Premium	6,00%
Beta Unlevered (Bu)	0,7955
Ru	5,24%
Beta Equity (Be) (relevering)	0,853
Re	5,59%
"Implied" Bd	0,506
Rd	3,50%
D/E	0,20
Wacc	5,1%

Source: Analyst forecasts

The weighted average cost of capital (WACC) was the rate of return used to evaluate Meliá's business.

As the company currently does not have any long term bonds, and it is not rated by any relevant credit agency, it was not possible to either assess to any yield or to compute any credit loss rate that could lead to an estimation of the correspondent cost of debt. Furthermore, the group has decreased its interest expenses, mainly as a consequence of successful debt renegotiations. As an alternative, we assumed the cost of debt as the ratio between the interest expenses reported for the year of 2016 and the financial liabilities, adjusted by the spread with the Euro 10 year verified swap rate. Thus, we reached to a 3.5% cost of debt.

Exhibit 31: Meliá's equity beta CI

	Lower 95%	Upper 95%
Beta	0.32	1.41

Source: Analyst forecasts

The cost of equity was calculated through the Capital Asset Pricing Model (CAPM), applying the respective formula and using the following inputs: risk free rate, levered equity beta, and market risk premium. Regarding the risk free rate, it should be a rate of return free of default and free of interest rate risk (reinvestment). Furthermore, we consider the current yield of the 10 year German Government Bund to be a good proxy (0.46%)[8]. Regarding the equity beta, a levered beta was computed regressing the returns of the group in excess of the risk free rate with the excess returns of the MSCI World Index[9]. However, as this

[8] Market value as of 2nd January 2018
[9] From a 5-year monthly return's horizon

levered beta does not describe the current capital structure of the company, it should be first unlevered and then "relevered" for the correspondent target debt to equity ratio (D/E), at market value. To unlever the equity beta we conducted a comparable's method, using the 5 peers mentioned above. The levered beta of each competitor was thus unlevered taking into account the respective D/E ratios at market values. The average of the unlevered betas was then used to calculate the relevered equity beta for Meliá. As the values for each competitor is within the confidence interval of the previous regression, we do not consider any as an outlier. Having all the inputs needed to apply the CAPM formula, we reached a 5.59% cost of equity.

Exhibit 32: Peers summary table

Comparables	Unlevered Beta
MEL SM Equity	0.67
NHH SM Equity	0.78
IHG LN Equity	0.89
MAR US Equity	1.06
AC FP Equity	0.42
HLT US Equity	0.95
Average	0.80

Source: Analyst forecasts

Looking for the historical capital distribution of the group, we can see that the company has been deleveraging its capital structure, as a result of the asset light strategy adopted by the group. Indeed, as the group only plans to retain some strategic assets, we should expect a debt deleveraging characterized by a lower D/E than the current ratio[10]. Thus, we will assume a target D/E ratio of 0,20. Furthermore, it is expected that the cost of equity would have a higher weight when computing the weighted average cost of capital.

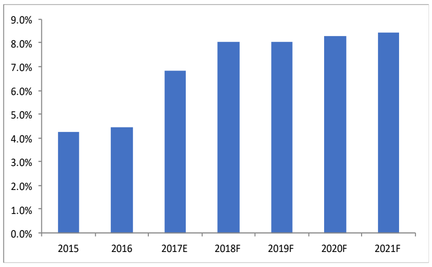
Even though some operations of Meliá are located in countries with higher alleged risks, no country risk premium was included when assessing the discount rate. Even so, all perceived risks were comprised in the valuation. Indeed, the systematic risks associated with a non-diversifiable nature are all included in the levered beta; the diversifiable risks are included in the cash flows, as well as some systematic risks. Hence, for the market risk premium one should only account for the excess return investors received from investing in the market instead of investing in the risk-free asset. A 6% market risk premium was assumed, in accordance to some academic literature.

To sum up, having all the necessary inputs, and applying the respective formula, a 5.1% weighted average cost of capital was reached.

Discounted Cash Flow Valuation Analysis

Based on the assumptions mentioned above, we are able to obtain the Operating Free Cash Flow for each of the explicit forecasted years. Furthermore, by performing a DCF valuation, we obtain the present value of each year's Operating Free Cash Flow.

Exhibit 33: Return on Invested Capital (ROIC)



Source: Analyst forecasts

Moreover, looking at the group's Return on Invested Capital (ROIC) for each year, we spot on a stabilization of this value in the years of 2020-2021. Thus, computing the terminal value starting from 2022 is sustained by this assumption.

[10] Current D/E ratio (market value): 0.38

We forecasted a 1.9% perpetuity growth rate by weighting the 2021F expected growth of the economies in the different regions where Meliá operates with the respective contribution of each region to the operating income.

Thus, having the present value of the operating cash flows for each of the forecasted years, and also the present value of the terminal value, we are able to obtain the group's enterprise value. In order to reach the equity value, we subtracted the value of the net financial assets for the year of 2017E (21.36 EURmn), reaching to an equity value of 3,932 EURmn. With the company having 230 million shares outstanding, we reached a 17.24 price per share.

With a price target of 17.24 Euros, along with a dividend payment of 13.5 cents in the financial year of 2018 the recommendation is to buy Meliá's stock, with an expected one-year upside of 50%.

DCF Valuation

€ in millions	2018	2019	2020	2021	2022 - Perp.
Free Cashflow		114	129	132	
Present Value of Free Cash Flows		108	117	114	
Present Value of all Free Cash Flows	340				
Terminal Value					4 227
Present Value of Terminal Value	3 642				
Entity Value (Firm Value)	3 981				
Net Financial Assets/Obligations	21				
Equity Value	3 960				
Shares Outstanding (millions)	230				
Price per Share	17,24				

Multiple Valuation

An additional multiple valuation was conducted in order to assess how Meliá is valued amongst its main competitors. This valuation had in account the five peers described above, and after a thorough examination, some outliers were excluded from the analysis. Additionally, we disregarded a valuation conducted using the Price/Sales multiple, as the EBITDA margins between Meliá and some of its peers are extremely different, and thus would not translate the correct price of Meliá. Also, a valuation using a Price/Book multiple was also not used, since the ROIC and ROA of some of the group's peers were much higher than the average, and that would translate in higher market value for those companies, as they are able to earn higher returns for its invested capital and assets.

Furthermore, the multiple valuation was conducted using the EV/EBITDA and the Price/Earnings (P/E) multiple. With regards to the EV/EBITDA multiple, the company is trading at a discount of the industry average. This could be in part justified by the smaller scale, and higher weight of owned and leased hotels at the moment, when compared to some of its competitors, which normally yield lower ROIC levels compared to more concentrated management and franchised models. Considering now the P/E multiple, the group is trading at a discount, compared to the industry average. More specifically, following the industry average P/E average of 40.1 we reach to a fair value of 18.80 Euros and thus, it is reiterated a "Buy" recommendation for the stock.

Tikcer	Name	Market Cap (billion)	EV / EBITDA	P/E
MEL SM Equity	Melia Hotels International	2.54	13.39	21.02
NHH SM Equity	NH Hotel Group SA	2.11	10.24	61.48
IHG LN Equity	InterContinental Hotels Group	9.41	15.28	26.66
AC FP Equity	Accor SA	12.26	24.87	62.62
MAR US Equity	Marriott International	38.85	17.81	32.84
HLT US Equity	Hilton Woeldwide Hotels	20.76	14.10	35.89
	Average	14.3	15.9	40.1

Sensitivity Analysis

In order to assess how small variations of the perpetuity growth rate and the rate of return may affect the final fair value of the company's share price, a sensitivity analysis is now conducted.

Volatility in the WACC may be registered mainly due to movements in the considered equity beta. The equity risk premium should not experience any significant changes as it has shown to be constant throughout time. Moreover, as the company has little debt in its capital structure, the cost of capital would be more affected by variations in the cost of equity rather than the cost of debt. Hence, WACC is more likely to be affected either by changes in the cost of equity.

Furthermore, this analysis also considers the effects on the price target resulted from changes in the perpetuity growth rate, which due to its unpredictable nature may register slight variations. However, having in account the forecasts for the future, considering growth rates too far from the base scenario does not seem much realistic.

Sensitivity Analysis

	SHARE PRICE	WACC				
	17,89	4,00%	4,50%	5,09%	5,50%	6,00%
Perpetual Growth	1,00%	19,33	16,64	14,31	13,05	11,79
	1,50%	22,88	19,15	16,08	14,49	12,93
	1,90%	26,95	21,86	17,91	15,93	14,04
	2,50%	37,10	27,95	21,70	18,80	16,19
	3,00%	54,88	36,76	26,53	22,26	18,64

Scenario Analysis

The hospitality sector faces several external risks that could have a meaningful impact to the industry. Indeed, Meliá has several external risks inherent to its operational activity. We now present the external risks that we believe could have more impact to the company:

- Changes in the regional and global economic cycles.
- Natural disasters and catastrophes; food and health crises.
- Political or social crises; geopolitical conflicts; acts of terrorism.
- Exchange rate differentials.
- Reversal of expectations of growth in the global tourism sector.

Indeed, these risks could impact the operational results of the company, reflecting in higher or lower margins.

In this section, we will analyse the impact on the fair value of a reversal of expectations of growth in the global tourism sector in the long-run to a more conservative scenario – a downside scenario.

In the "bear" scenario, we would consider that, as the tourism sector suffered a reversal of expectations starting in 2019 "ceteris paribus", having lowered the forecasts for the international tourism arrivals, the occupancy rates would be lower. Indeed, we will only start to downgrade the occupancy rates starting in 2019, as the long term is more uncertain and thus, more exposed to external risks.

Occupancy Rates by Region	2015	2016	2017E	2018F	2019F	2020F	2021F
Spain	67.0%	67.5%	68.3%	69.1%	68.7%	68.3%	67.9%
EMEA	72.8%	71.9%	72.7%	73.6%	73.1%	72.7%	72.3%
Mediterranean	72.4%	79.1%	80.0%	80.9%	80.5%	80.0%	79.5%
America	70.8%	69.3%	70.1%	70.9%	70.5%	70.1%	69.7%
Total	70.8%	71.6%	73.1%	74.0%	73.5%	73.1%	72.7%

Considering the management fees, we would also reduce the expectations of growth, in accordance to the downgrade of international tourist arrivals.

Management fees growth (%)	2016	2017E	2018F	2019F	2020F	2021F
Spain (Urban)	-18.3%	5.0%	1.0%	-1.0%	-1.0%	-1.0%
EMEA	18.5%	5.0%	15.0%	-5.0%	-5.0%	-2.0%
Mediterranean	-11.9%	10.0%	7.0%	-3.0%	-3.0%	-2.0%
America	20.0%	10.0%	10.0%	-2.0%	-2.0%	-2.0%
Cuba	30.8%	-5.0%	20.0%	-5.0%	-3.0%	-3.0%
Brazil	-43.9%	20.0%	10.0%	-3.0%	-2.0%	-2.0%
Asia	18.8%	15.0%	20.0%	-5.0%	-5.0%	-5.0%
TOTAL	5.5%	3.3%	13.5%	-3.9%	-3.0%	-2.6%

This reversal of expectations would lower the price target of Meliá's shares to 10.09 Euros, which reflects a 1-year loss of -12.0%, assuming a same 13.5 cents dividend payment.

Appendix

Financial Statements

Consolidated Profit and Loss Account (As Reported)	2016	2017E	2018F	2019F	2020F	2021F
Operating Income	1802.0	1920.1	2000.1	2094.4	2181.9	2272.2
Expenses	-222.8	-240.4	-250.4	-262.2	-273.2	-284.5
Staff Costs	-489.7	-512.5	-552.8	-604.2	-642.4	-679.5
Other Costs	-640.2	-666.5	-694.3	-727.0	-757.3	-788.7
EBITDAR	449.3	500.7	502.6	501.0	509.0	519.5
Leases	-163.7	-174.5	-181.7	-190.3	-198.2	-206.5
EBITDA	285.6	326.3	320.9	310.7	310.7	313.0
Restructurings	0.0	0.0	0.0	0.0	0.0	0.0
Amortizations and depreciations	-104.3	-101.2	-101.2	-103.3	-104.7	-106.1
Impairments	-7.2	-7.2	-7.2	-7.2	-7.2	-7.2
Negative Consolidated Difference	1.6	0.0	0.0	0.0	0.0	0.0
Translation Differences	-45.4	-60.0	-30.0	-15.0	-7.5	-3.8
EBIT/ Operating Profit	175.7	157.9	182.5	185.2	191.3	196.0
Exchange Results	4.7	4.7	4.7	4.7	4.7	4.7
Bank Financing	-42.1	-28.0	-25.0	-23.2	-20.7	-18.1
Other Financial Results	7.7	7.7	7.7	7.7	7.7	7.7
Net financial result	-29.7	-15.6	-12.6	-10.8	-8.4	-5.7
Profit /(Loss) of associates and joint ventures	1.6	1.6	1.6	1.6	1.6	1.6
Net income Before Taxes	147.6	143.8	171.4	176.0	184.5	191.9
Corporate Income Tax	-44.6	-36.0	-42.9	-44.0	-46.1	-48.0
Results from continued operations						
Results from discontinued operations						
Consolidated Profit of the year/Net income	102.9	107.9	128.6	132.0	138.4	143.9
A)Attributed to the parent company	100.7	105.5	125.8	129.1	135.4	140.7
B)Attributed to minority interests	2.3	2.4	2.8	2.9	3.0	3.2
Basic Earnings per share (cents)	0.4	0.5	0.6	0.6	0.6	0.6
Diluted earnings per share (cents)	0.4	0.5	0.6	0.6	0.6	0.6
Total other comprehensive results	-40.0	-40.0	-40.0	-40.0	-40.0	-40.0
Total comprehensive income	62.9	67.8	88.5	91.9	98.4	103.9
A) Attributed to the parent company	59.0	63.7	83.1	86.3	92.3	97.5
B) Attributed to minority interests	3.9	4.2	5.5	5.7	6.1	6.4

Balance Sheet (As reported)	2016	2017E	2018F	2019F	2020F	2021F
ASSETS						
Non-current assets						
Goodwill	60.8	60.8	60.8	60.8	60.8	60.8
Other Intangible Assets	109.3	109.3	109.3	109.3	109.3	109.3
Tangible Fixed Assets	1693.4	1639.0	1639.0	1676.4	1701.3	1726.3
Property Investments	141.1	141.1	141.1	141.1	141.1	141.1
Investments in joint ventures and associates	190.1	191.0	191.0	191.0	191.0	191.0
Other non-current financial assets	209.9	209.9	209.9	209.9	209.9	209.9
Deferred tax assets	135.9	144.9	150.9	158.0	164.6	171.4
Total Non-current assets	2540.6	2496.0	2502.1	2546.5	2578.1	2609.8
Current Assets						
Non- current assets held for sale						
Inventory	64.0	69.5	71.8	74.8	77.7	80.8
Trade and other receivables	275.3	293.3	305.5	319.9	333.3	347.1
Income Tax assets	29.6	31.6	32.9	34.4	35.9	37.3
Other current financial assets	47.3	50.4	52.5	55.0	57.3	59.6
Cash and cash equivalents	366.8	390.8	407.1	426.3	444.1	462.5
Total Current assets	782.9	835.6	869.8	910.4	948.2	987.4
Total Assets	**3323.5**	**3331.6**	**3371.8**	**3456.9**	**3526.3**	**3597.2**
EQUITY						
Net equity imputed to the parent company	1520.3	1557.1	1614.6	1675.5	1742.8	1815.6
Non-controlling interests	43.3	44.4	46.0	47.7	49.6	51.7
Total Net Equity	1563.6	1601.5	1660.6	1723.2	1792.4	1867.3
LIABILITIES						
Non-current liabilities						
Bonds and other negotiable securities	47.8	0.0	0.0	0.0	0.0	0.0
Bank borrowings	570.9	498.2	479.0	444.7	392.2	333.9
Other non-current financial liabilities	13.8	14.7	15.3	16.0	16.7	17.3
Capital grants and other deferred income	28.6	28.6	28.6	28.6	28.6	28.6
Provisions	35.6	38.4	40.0	41.9	43.6	45.4
Deferred tax liabilities	184.7	196.8	205.0	214.7	223.6	232.9
Total Non-current liabilities	881.4	776.6	767.8	745.8	704.7	658.1
Current liabilities						
Liabilities associated with non-current assets held for sale						
Bonds and other negotiable securities	39.5	89.9	43.8	45.9	47.8	49.8
Bank borrowings	251.0	230.4	240.0	251.3	261.8	272.7
Trade Payables and other accounts payable	459.7	496.0	516.7	541.0	563.6	587.0
Income tax liabilities	33.2	35.9	37.4	39.1	40.8	42.4
Other current financial liabilities	95.1	101.3	105.6	110.5	115.2	119.9
Total Current liabilities	878.5	953.5	943.5	987.9	1029.2	1071.8
Total Liabilities	1759.9	1730.1	1711.3	1733.7	1733.9	1729.9
Total equity and liabilities	**3323.5**	**3331.6**	**3371.8**	**3456.9**	**3526.3**	**3597.2**
Net Debt	679.9	572.3	505.1	470.7	418.2	359.7
Net Debt/EBITDA	2.4	1.8	1.6	1.5	1.3	1.1

Cash flow Map					
€ in millions	**2017**	**2018**	**2019**	**2020**	**2021**
Net sales	1920	2000	2094	2182	2272
Cost of sales	-240	-250	-262	-273	-284
Gross profit	1680	1750	1832	1909	1988
Other operating income & expenses	-1520	-1566	-1645	-1716	-1790
Operating profit	159	184	187	193	198
Notional Taxes	-36	-43	-44	-46	-48
Operating Income After Taxes	123	141	143	147	150
Change in NWC (-)	16	7	8	8	8
CAPEX (-)	-47	-101	-141	-130	-131
Depreciation (+)	101	101	103	105	106
Free Cashflow	193	149	114	129	132

Disclosures and Disclaimers

Report Recommendations

Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

This report was prepared by José Miguel Branquinho, a Master in Finance’s student of Nova School of Business & Economics (“Nova SBE”), within the context of the Field Lab – Equity Research.

This report is issued and published exclusively for academic purposes, namely for academic evaluation and master’s graduation purposes, within the context of said Field Lab – Equity Research. It is not to be construed as an offer or a solicitation of an offer to buy or sell any security or financial instrument.

This report was supervised by Francisco Martins, acting merely in an academic capacity, who revised the valuation methodology and the financial model.

Given the exclusive academic purpose of the reports produced by Nova SBE students, it is Nova SBE understanding that Nova SBE, the author, the present report and its publishing, are excluded from the persons and activities requiring previous registration from local regulatory authorities. As such, Nova SBE, its faculty and the author of this report have not sought or obtained registration with or certification as financial analyst by any local regulator, in any jurisdiction. In Portugal, the author of this report is not registered with or qualified under COMISSÃO DO MERCADO DE VALORES MOBILIÁRIOS (“CMVM”, the Portuguese Securities Market Authority) as a financial analyst. Rosário André - as the academic supervisor of the author - is registered as a financial analyst with CMVM. No approval for publication or distribution of this report was required and/or obtained from any local authority, given the exclusive academic nature of the report.

The additional disclaimers also apply:

USA: Pursuant to Section 202 (a) (11) of the Investment Advisers Act of 1940, neither Nova SBE nor the author of this report are to be qualified as an investment adviser and, thus, registration with the Securities and Exchange Commission (“SEC”, United States of America’s securities market authority) is not necessary. Neither the Author nor Nova SBE receives any compensation of any kind for the preparation of the Reports.

Germany: Pursuant to §34c of the WpHG (*Wertpapierhandelsgesetz*, i.e., the German Securities Trading Act), this entity is not required to register with or otherwise notify the *Bundesanstalt für Finanzdienstleistungsaufsicht* (“BaFin”, the German Federal Financial Supervisory Authority). It should be noted that Nova SBE is a fully-owned state university and there is no relation between the student's equity reports and any fund raising programme.

UK: Pursuant to section 22 of the Financial Services and Markets Act 2000 (the "FSMA"), for an activity to be a regulated activity, it must be carried on "by way of business". All regulated activities are subject to prior authorization by the Financial Conduct Authority ("FCA"). However, this Report serves an exclusively academic purpose and, as such, was not prepared by way of business. The author - a Masters' student - is the **sole and exclusive responsible** for the information, estimates and forecasts contained herein, and for the opinions expressed, which exclusively reflect his/her own judgment at the date of the report. Nova SBE and its faculty have no single and formal position in relation to the most appropriate valuation method, estimates or projections used in the report and may not be held liable by the author's choice of the latter.

The information contained in this report was compiled by students from public sources believed to be reliable, but Nova SBE, its faculty, or the students make no representation that it is accurate or complete, and accept no liability whatsoever for any direct or indirect loss resulting from the use of this report or of its content.

Students are free to choose the target companies of the reports. Therefore, Nova SBE may start covering and/or suspend the coverage of any listed company, at any time, without prior notice. The students or Nova SBE are not responsible for updating this report and the opinions and recommendations expressed herein may change without further notice.

The target company or security of this report may be simultaneously covered by more than one student. Because each student is free to choose the valuation method, and make his/her own assumptions and estimates, the resulting projections, price target and recommendations may differ widely, even when referring to the same security. Moreover, changing market conditions and/or changing subjective opinions may lead to significantly different valuation results. Other students' opinions, estimates and recommendations, as well as the advisor and other faculty members' opinions may be inconsistent with the views expressed in this report. Any recipient of this report should understand that statements regarding future prospects and performance are, by nature, subjective, and may be fallible.

This report does not necessarily mention and/or analyze all possible risks arising from the investment in the target company and/or security, namely the possible exchange rate risk resulting from the security being denominated in a currency either than the investor's currency, among many other risks.

The purpose of publishing this report is merely academic and it is not intended for distribution among private investors. The information and opinions expressed in this report are not intended to be available to any person other than Portuguese natural or legal persons or persons domiciled in Portugal. While preparing this report, students did not have in consideration the specific investment objectives, financial situation or particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in any security, namely in the security covered by this report.

The author hereby certifies that the views expressed in this report accurately reflect his/her personal opinion about the target company and its securities. He/ She has not received or been promised any direct or indirect compensation for expressing the opinions or recommendation included in this report.

The content of each report have been shown or made public to restricted parties prior to its publication in Nova SBE's website or in Bloomberg Professional, for academic purposes such as its distribution among faculty members for students' academic evaluation.

Nova SBE is a state-owned university, mainly financed by state subsidies, student's tuition fees and companies, through donations, or indirectly by hiring educational programs, among other possibilities. Thus, Nova SBE may have received compensation from the target company during the last 12 months, related to its fund raising programs, or indirectly through the sale of educational, consulting or research services. Nevertheless, no compensation eventually received by Nova SBE is in any way related to or dependent on the opinions expressed in this report. The Nova School of Business & Economics does not deal for or otherwise offer any investment or intermediation services to market counterparties, private or intermediate customers.

This report may not be reproduced, distributed or published, in whole or in part, without the explicit previous consent of its author, unless when used by Nova SBE for academic purposes only. At any time, Nova SBE may decide to suspend this report reproduction or distribution without further notice. Neither this document nor any copy of it may be taken, transmitted or distributed, directly or indirectly, in any country either than Portugal or to any resident outside this country. The dissemination of this document other than in Portugal or to Portuguese citizens is therefore prohibited and unlawful.