

<b>Recommendation Change</b>	<b>Aitken Spence Hotel Holding Ltd (AHUN)</b>	<b>Hold</b>
<b>Summary</b>	<b>Downgrade to Hold</b>	<b>3<sup>rd</sup> October</b>

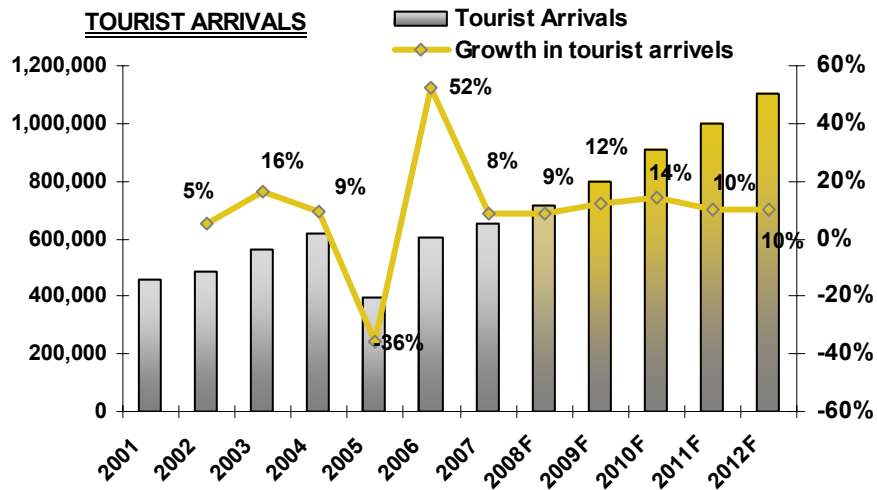
<p><b>Recommendation</b> <b>Hold</b></p> <p><b>Share Price</b> <b>Rs.75.00*</b></p> <p><b>ASPI</b> <b>2573.75*</b></p> <p><b>MPI</b> <b>3493.70*</b></p> <p><b>Analyst</b> <b>Amal Sanderatne,</b> <b>CFA</b></p> <p><b>Varuni De Silva</b></p> <p><i>*CSE data as on 2nd October 2007</i></p>	<ul style="list-style-type: none"> <li>◆ With the counter appreciating sharply in value and currently trading very close to our target price of Rs77.52, we have revised down our recommendation of AHUN from a Buy to a Hold.</li> <li>◆ We had set a target price of Rs.77.52 when we released our initial report on 8<sup>th</sup> August when the counter was trading at Rs.58.00, and the sharp rise in the counter since then has been far in excess of the rise in the overall market.</li> <li>◆ The recent bomb in Male is also a significant factor in our downgrade of the counter given the bulk of the companies current value is on account of its' highly profitable exposure to Maldivian tourism.</li> <li>◆ At this point news reports seem to indicate a limited impact on tourism bookings, and the fact that no organised group had taken responsibility for the bombings suggests that this could be a one off event.</li> <li>◆ However should there be a second attack, the impact on Maldivian tourism could be very significant and would result in a sharp fall in earnings for AHUN.</li> <li>◆ Risk averse investors who are currently sitting on a significant profit could consider taking profit at current levels.</li> </ul>
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**Impact of bombing in Maldives**

Prior to the bomb in Male, a perception of an almost complete lack of danger from terrorism was an important competitive advantage Maldives had in attracting tourists. However the natural beauty of the isolated resorts, shallow seas, coral reefs and unpolluted beaches were the critical differentiating factors that have created a highly profitable tourism that focussed largely at the high end tourist.

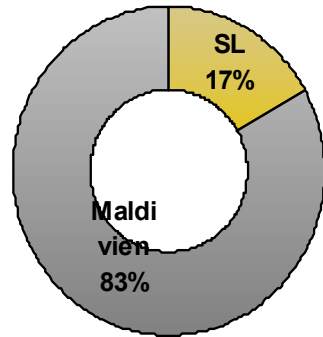
Should the bombing be perceived as being a one off event as current news reports indicate, there would be minimal impact on Tourism. The post Tsunami recovery of Maldivian tourism supports this view of resilience of tourism in the Maldives, as the perception is that a Tsunami impact on the Maldives is a “once in a life time event”.

The Underneath Chart shows the continued historic growth and future expectations for Maldivian tourism, which has already recovered from the Tsunami impact.

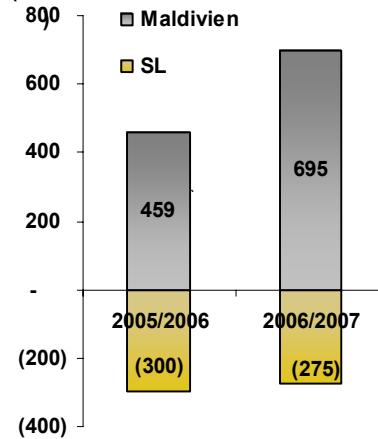


*\*Source: Maldivian Ministry of Tourism & Civil Aviation*

**Revenue Composition  
2006/2007**



**PBT (Rs.Mn)** Profit Composition



From a financial perspective, though Maldivian tourism is catering to the high end market, the cost structure to resort operators is also high. There is a relatively high operating cost structure due to resorts being on separate islands, with all the staff staying in the resort. In addition to that, given that Maldivian resorts have been and are expected to be very profitable with limited risk, the cost of leasing an island and the taxes on tourism are also relatively high and are agreed at the onset of a resort lease. As such, should there be a sharp downturn in Maldivian tourism due to terrorist incidents there is a very high potential downside to a possible loss making situation as well.

Thus for instance for AHUN in 2006/2007 of a total Maldivian Revenue of Rs3,760m the profits before tax from the segment was Rs695m or 18% of Revenue. Thus should terrorism risk become a significant issue, the profitability of 18%, could potentially see a complete erosion. The historic experiences however have been for the Maldives to see an almost continuous growth in rates annually.

### **Valuation**

Our original valuation of Rs.77.52 was by discounting the base case valuation by 20%. The base case valuation of Rs.96.62 was derived using "Sum of Parts Basis" taking in to account the different growth prospects of the Maldivian and Sri Lankan hotel sector. Our valuation for the Sri Lankan segment was on a pessimistic basis to take an

absolute base value even in an adverse scenario.

Though there is more positive sentiments on tourism in Sri Lanka in recent weeks, given that rates in Sri Lanka remain low, even with an improvement in occupancy, Sri Lankan tourism is still likely to record a loss. As such our valuation of Rs41.2 per share for Sri Lanka Tourism segment of AHUN remains.

Though with the current situation we do not anticipate any significant change to our outlook for Maldivian tourism, we are looked at our sensitivity analysis to take a no growth case for the Maldivian operation in dollar terms, as compared to our original 2% growth forecast in dollar terms. In this situation our valuation for the Maldivian operation would be Rs.59.69 compared to Rs63.05 we had earlier.

Discount Rate		Growth Rate				
		-5%	-2%	0%	1%	2%
	15%	66.89	78.36	87.50	92.61	98.11
	20%	54.94	63.30	69.84	73.45	77.31
	24%	47.86	54.53	59.69	62.51	65.52
	25%	46.34	52.67	57.55	60.22	63.05
	28%	42.27	47.73	51.89	54.16	56.55

	Previous Valuation	No Growth Valuation
Maldivian Operations	65.52	59.69
SL Operations	41.2	41.2
Adjustment	-9.8	-9.8
Fair Valu	96.92	91.09
20% Discount	<b>77.54</b>	<b>72.87</b>

Looking at the combined valuation on a zero growth basis with a 20% discount to the derived value would suggest our target price should be Rs72.87 compared to Rs77.54.

**Valuation on extremely conservative assumptions.**

However it is apparent that the valuation made is based on extremely conservative assumptions. Even with the fair value of over Rs90 per share we have taken a further discount. We have not incorporated any value to other hotel investments and management opportunities the company could get into. We have in fact not attributed any value to the two Indian resorts that commenced operation recently or the other management agreements the company has secured in India. We have also not taken into account any revenues from the Maldives after the current leases on the existing hotels run out, nor potential revenues or growth from new leases which would appear to be a very conservative assumption. The Sri Lanka valuation is on very conservative values placed on assets, which may appear to be below actual potential sale values. All this suggests a fair value that is far in excess of what we have projected.

**However further terrorist strikes on the Maldives is a large risk.**

However at the same time should there be further terrorist attacks on resorts on the Maldives, earnings could potentially be wiped out and lead to Maldives being at a much depressed value to what we have calculated, even below that re-done in a zero growth case. Unlike in Sri Lanka the resorts are on lease and not on a free hold basis, so an asset based valuation would not be as appropriate. Investor action on the counter would be very much based on their perceptions of the likelihood of further terrorist strikes in the Maldives.

**Summary Forecasts**

Group	2005/6	2006/7	2007/8	2008/9	2009/10
<b>Gross Revenue</b>	2,560,479	4,299,987	4,402,195	4,475,533	4,550,000
YoY		68%	2%	2%	
<b>Results from operating activities</b>	176,546	657,879	882,332	895,659	909,000
YoY		273%	34%	2%	
<b>PAT after Minority Interest after Preference Dividend</b>	158,997	187,741	226,359	271,720	321,000
YoY		18%	21%	20%	
<b>EPS</b>	4.14	4.88	5.89	7.07	8.50

## Appendices

### **Company Profile**

Ahungalla Hotels Ltd was incorporated in 1978 as a public quoted company. The company grew over time and with the commencement of commercial operations at Triton Hotel, in 1986 the company increased the authorized share capital from Rs.100mn to Rs.500mn. In 1994 the company acquired approximately 97% of the share capital of Aitken Spence Hotels Ltd and gained the controlling interest of Neptune Hotel, Kandalama Hotel and Pearl Beach Hotel. The company also acquired the Aitken Spence & Co. Ltd's, investment in Browns Beach Hotel and Hotel Hilltop. The company acquired a majority holding in Hethersett Hotels Ltd. Also the company acquired Crest star Ltd, from Aitken Spence & Co. Ltd and gained controlling interest in Club Rannalhi and Bathala Resorts, Maldives. In 2000 Meedhupparu Island Resort was launched in the Maldives. In 2006 the company's new, Heritage, brand was launched and in 2007 renovations were completed. Also in 2007 the company acquired its fourth resort in Maldives "Adaaran Select Hudhuranfushi". More over the company ventured into India and seems to be successful in securing management contracts for five resorts.

*Highlights of Performance of Specific Hotels for the financial year ended 31<sup>st</sup> March 2007*

- **Heritage Kandalama** - Managed to generate a healthy operating profit despite depressed tourist arrivals.
- **Heritage Ahungalla** - The revenue generated during the year was insufficient to make an operating profit.
- **Hethersett Hotels Ltd (Tea Factory)** - The revenue generated decreased by 18% in the year under review while the operating profit declined 56% compared to the previous year due to the effects of adverse weather condition and rising security concerns.
- **Neptune Hotel** - Despite difficult conditions, it recorded a 15% growth in revenue and an increase of 34% in operating profit.
- **Neptune Ayurveda Hotel** – This recorded a 10% revenue growth and a 9% growth in operating profits over the previous year. The Company's decision to convert 20 under utilized rooms in the main hotel to a fully-fledged Ayurveda facility has generated favourable results.

The Maldivian operations are undertaken under the newly launched brand “ADAARAN”, as brand differentiation. According to the Board *“brand Adaaran in the Maldives during the year brought luxury, niche, boutique style resorts in the Maldivian market, under one identity”*.

- **Adaaran Select Meedharapparu** - Is one of the largest hotels in the Maldives. Its revenues increased 52% and the operating profit recorded a sound growth of 63% over last year, and this is a result of

the growth in Maldivian tourism which increased the occupancy rates and hotel's rates.

- **Adaaran Club Ranalhi** - resort has performed impressively via the exploitation of long term guaranteed tie-ups with major tour operators. The resort achieved a revenue growth of 44% and a rise in operating profit of 35%.
  
- **Adaaran Club Bathala** - has recorded an increase in revenue of 32% and a substantial increase of 34% in the operating profit, with the strategic marketing decision to give the entire island to an Italian operator on a short term basis, paid rich dividends as the resort revenues surpassed all previous levels.
  
- **Adaaran Select Hudhuranfushi** - the former Lohifushi resort, was launched in November 2006 and it has generated impressive results during its shorter operating period.

With a further expansion of the portfolio of resorts, the Company has implemented the expansion strategy via a plan, and succeeded in finalizing contracts to manage five resorts in diverse tourism spots such as Kerala, Tamil Nadu and Delhi in India. Two resorts will be managed under the flagship brand "Heritage" and the remaining under "Aitken Spence Hotels and Resorts". According to Chief Executive "Negotiations are currently underway to finalise agreements for further Resorts". Three of the resorts will come on stream during the next financial year while another two resorts may commence operations in the following financial year.

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