Recommendation Change	**Aitken Spence Hotel Holdings Ltd (AHUN)**	**Buy**
Summary	**Upgrade to Buy**	**6th November**

Recommendation

Buy

Share Price

Rs.69.75*

ASPI

2,632*

MPI

3,538*

Analyst

Amal Sanderatne, CFA

Varuni De Silva

**CSE data as on 5th November 2007*

- We have upgraded AHUN to a BUY from the Hold recommendation we had on the counter following the bomb blast in Male and have an upgraded twelve month target price of Rs87.

- Our upgrade is led by the fact that the stock price has fallen to Rs.69.75 from Rs.75 at the time of the downgrade to Hold, while at the same time the discount rate we use has fallen by 100basis points in line with the fall in long term interest rates following the sovereign bond issue.

- Furthermore the valuation we placed on it's Sri Lanka assets appears to be very conservative given the price paid in the JKH acquisition of Confifi group hotels and we have upgraded the valuation place on AHUN Sri Lanka assets

- AHUN has continued to invest in the Maldives, with news of the recent acquisition of Vadhoo Island Resort, but our valuation does not take into account the upside from this or any further acquisitions.

- Our main concern continues to be the risk of terrorism in the Maldives, but the fact that there has no subsequent attacks, or even either claims or allegations that a specific organised terrorist group was involved in the attack suggest that the incident may be one off. However should their be any future attacks in the Maldives, or any organised terrorist group warning of future attacks, there would be a complete and immediate reversal of this view, with sharp impacts to the valuation of the counter, and it remains the key risk the counter faces.

Reverting to a 2% growth Assumption for Maldives.

- Following the bomb in Male we downgraded the valuations of the counter using a no growth assumption compared to the 2% growth assumption we were using earlier. We are now reverting to the 2% growth in dollar terms for our base case assumptions.
- In our Maldivian operation we continue to look at a discounted cash flow valuation methodology as AHUN has a finite lease period on these resorts that are generating these revenues.
- Cash flow growth in the base case scenario was projected at 10%, just 2% above our long term expectations for dollar depreciation.
- Though AHUN has been raising rates and adding significant value to the resorts we have taken a very conservative 2% annual rise in profitability on a dollar basis for the resort in the Maldives as there are limitations to capacity expansion and room rates are already at high levels.
- Compared to the earlier 24% discount rate we are now using a 23% discount rate for cash flows for the Maldivian operation which gives us a base value of Rs68.16 for the Maldivian operations.

	Growth Rate				
	-5%	0%	2%	4%	6%
15%	66.89	87.50	98.11	110.46	124.91
23%	49.47	61.97	68.16	75.20	83.25
24%	47.86	59.69	65.52	72.14	79.68
25%	46.34	57.55	63.05	69.28	76.36
28%	42.27	51.89	56.55	61.79	67.70

Original Valuation of Maldivian Cash Flows (August 2007)

October Valuation of Maldivian Cash Flow following the Bomb attack

Current Valuation of Maldivian Cash Flows

Dollar Cash flows and discount rates has a value of Maldivian Operations to Rs74.16

- We had earlier also explained how the dominant non Sri Lanka exposure of the counter allows us the option of valuing the non Sri Lankan Cash flow on international discount rates and risk premiums and as such serves to mitigate the issue of very high interest rates depressing equity valuations in Sri Lanka.

- The base case growth rate in this scenario is 2% in USD terms while we took an equity discount rate of 12%.Based on the above assumptions the base case value of Maldivian operation was Rs.74.16 per AHUN share but did not change with the local discount rate changing. Our Fair Value for the entire company and target price however is based on the lower valuation derived through the Sri Lanka Discount Rate.

Sri Lankan Valuation clearly conservative.

- When we did our Sri Lanka Hotels valuation previously it was an adjusted book value based approach to the Sri Lanka operations. We took extremely pessimistic assumptions in one case in our Sri Lanka valuation, while for the base case we looked at it from a still pessimistic but more realistic value for the Sri Lanka Hotels.

- Both these valuations were at substantial discount to new building or a replacement cost approach value for the hotels. With JKH groups offer to buy the Conffi group hotels now setting a market benchmark for asset values of hotels it is indicative to see how conservative we had been.

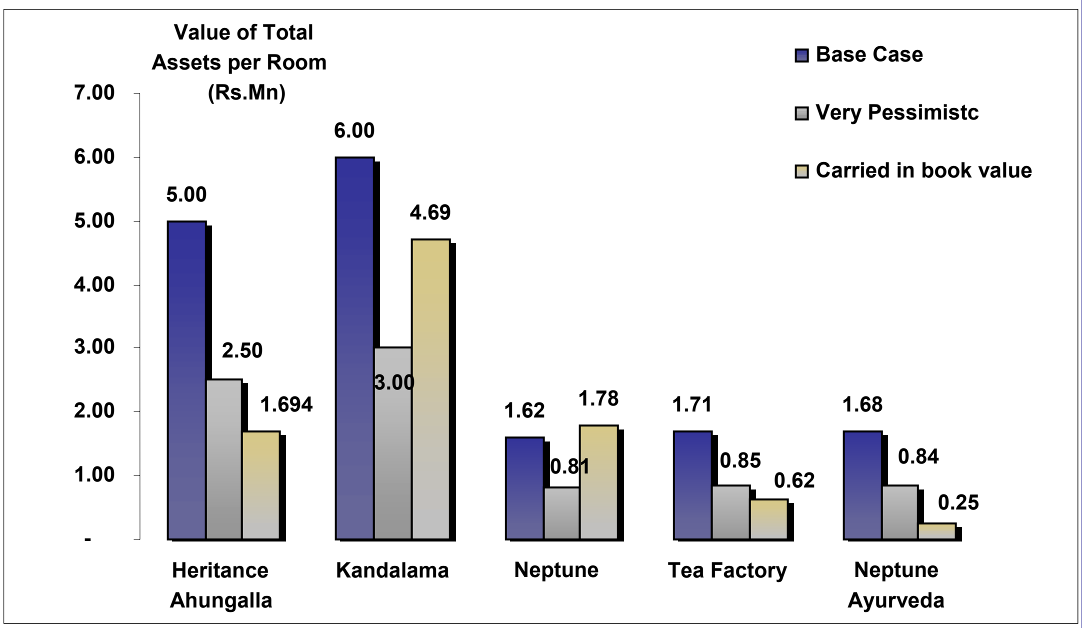
- The underneath is an estimate of what we have estimated the approximate value paid for the fixed assets in the Keells Hotels offer, at varied share prices of KHL. At the current Rs8 of KHL shares Eden rooms are at an approximate valuation of Rs5.3m per room while Riverina is Rs2.1m per room and Palm Garden is Rs1.9m per room.

Estimated Value for Assets on a Per Room basis in KHL offer based on different share prices of KHL

Aproximate Value Per Room	at 9	at 8	at 7
Eden	5.9	5.3	4.8
Riverina	2.3	2.1	1.8
Palm Garden	2.2	1.9	1.7
Average	3.4	3.1	2.7

- To get at these per room valuations on we took the total value of the offer at Rs. 8 per KHL share, added the debt in the books as at 30th June 2007 and subtracted the Current Assets in the books at each of the hotels to arrive at an implied Enterprise valuation per Room.

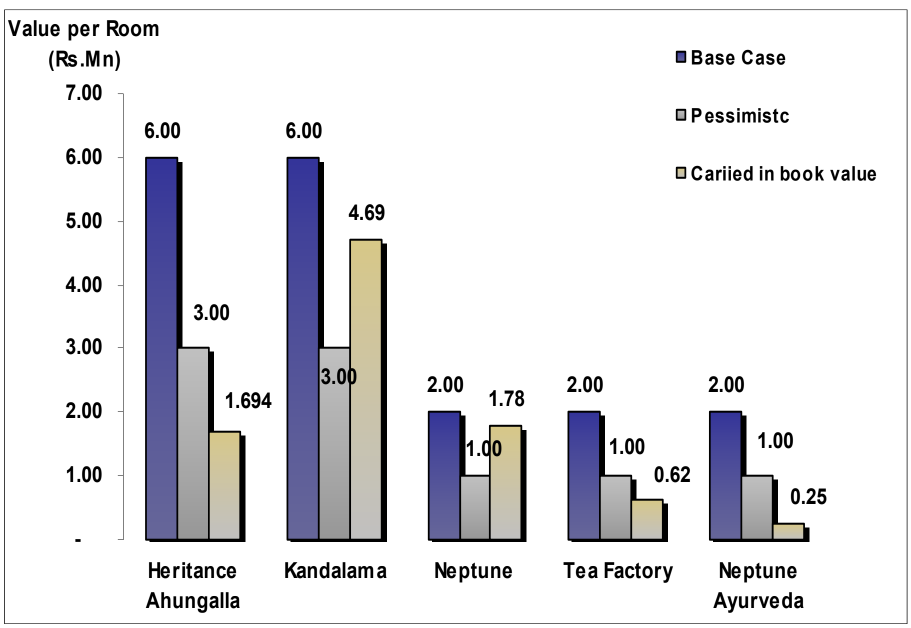
- The underneath is a Chart providing our original underlying basis of Valuation per Sri Lankan Hotel room of AHUN taken in the Very Pessimistic and Base Case, and also compared to what it is carried in the company accounts on a non consolidated basis.



- In our opinion Eden Rooms at Rs5.3m suggest that Kandalama and Heritance rooms at Rs6m and 5m respectively are at the low side of a valuation, and as such we have upgraded the value per Heritance room to Rs6m.

- Neptune and Tea Factory should at least be at Rs2m plus based on the value placed on Palm Garden and Riverina, rather than the Rs1.6m to Rs1.7m range we assumed previously in the base case. Even the Rs2m valuation we are now working with is in our view is extremely conservative.

- With these upgrades the base case value for the Sri Lanka Hotels comes to Rs50 per AHUN share. Underneath is a Chart of the New Value per room placed on the Sri Lanka Operations from which the Rs50 per share total value was derived.



- Given the fact that our Sri Lanka Hotel Valuation seem extremely conservative we have upgrade the value on the Sri Lanka Operations to come in line with comparative valuation of KHL The value per share for the Sri Lanka operations therefore rises from Rs41.2 to Rs.50.3 With the rise in the value of Maldivian Operations from Rs68.16 from Rs59.69 out total fair value on a conservative basis rise from Rs91.09 to Rs.108.7.7. To set a target price we have continued to apply a 20% discount given the volatility in the hotel sector and arrived at a new target price of Rs87 on a twelve month horizon

	August Valuation	October No Growth Valuation	Current Valuation
Maldivian Operations	65.5	59.7	68.2
SL Operations	41.2	41.2	50.3
Adjustment	-9.8	-9.8	-9.8
Fair Value	96.9	91.1	108.7
20% Discount to Target Price	**77.5**	**72.9**	**86.9**

Valuation on extremely conservative assumptions.

However it is apparent that the valuation made is based on extremely conservative assumptions. We have also taken a further discount on the fair value of over Rs108 per share. Even with the fair value of over Rs108 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, the potential revenues from the Vadhoo island resort it just announced and investment into, nor potential revenues or growth from new leases which would appear to be a very conservative assumption. All this suggests a fair value that is far in excess of what we have projected.

Continued Positive News Flow on Expansion

Vadhoo Island Resort: On 31st October 2007 company announced that Aitken Spence Hotels (International), a subsidiary of Aitken Spence Hotel Holdings, had acquired the Vadhoo Island Resort for 13 million US dollars.

Vadhoo Island Resort is a four star hotel located in the South Malé Atoll. The resort is only 8Kmaway from the Air Port (15mins by speed boat) The resort consist of 31 rooms, 16 Sun Deluxe Rooms, 8 Beach Cottages, 5 Luxury Over-water Bungalows and 2 Over-water Cottage Suites. Vadoo Island Resort pioneered the concept of the over-water cottage in the Maldives in early 1988.

Indian Operations Commence.

Two out of three resorts that were supposed to start operations this year have already started operations in India. Barefoot Resort in the Andaman Islands and Poovar Resort at Trivandrum are the latest two hotels that came under the management of Aitken Spence management. Three more Indian resorts are supposed to come on stream during the next financial year.

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 still 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	2010
Gross Revenue	2,560,479	4,299,987	4,402,195	4,475,533	4,550,337	4,626,638
YoY		68%	2%	2%	2%	2%
Results from operating activities	176,546	657,879	882,332	895,659	909,253	923,119
YoY		273%	34%	2%	2%	2%
PAT after Minority Interest after Preference Dividend	158,997	187,741	226,359	271,720	321,690	376,737
YoY		18%	21%	20%	18%	17%
EPS	4.14	4.88	5.89	7.07	8.37	9.80

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, Heritance, 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 31st March 2007

- **Heritance Kandalama -** Managed to generate a healthy operating profit despite depressed tourist arrivals.
- **Heritance 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.