

Date: 9th August 2007



Aitken Spence Hotel Holdings Limited

Company Report

Recommendation
BUY

Share Price
Rs 58.00

Market Cap
Rs.2,229,122,304

ASPI
2431.17

MPI
3331.19

Shares Issued
38,433,144

52 Week High
Rs.95.00

52 Week low
Rs.52.25

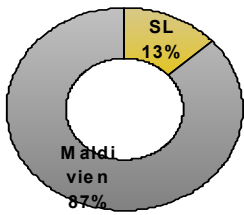
Analysts
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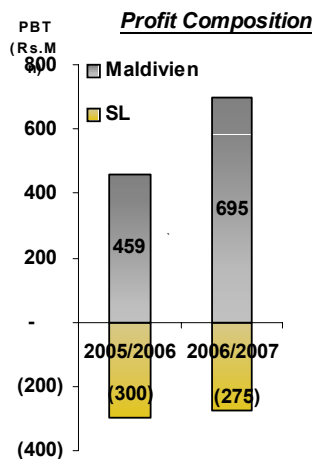
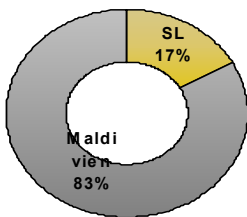
Aitken Spence Hotel Holdings(AHUN)- BUY

- The Company has successfully mitigated Sri Lanka's country risk by diversifying their operations outside of Sri Lanka.
- The Maldivian Tourism sector is poised for record growth this year while the Sri Lankan tourism sector outlook is still bleak. However the group managed to reduce its loss in the Sri Lankan hotels sector by 34%YoY in the first quarter.
- We have valued the counter the counter is on "sum of part basis" considering the differences in the future prospects of these geographical segments.
- The valuation of the Maldivian segment alone provides a value of Rs.65.52 per share. This alone provides is at a 13% premium to the current share price Rs58.00
- Even at an extremely conservative basis of valuation we have valued the sum of the existing Sri Lankan and Maldivian operation at Rs96.92 per share. Our 12 month forward target price of Rs77 is at a 20% discount to this value.

Revenue Composition
2005/2006



Revenue Composition
2006/2007



Valuing the Stock on a Sum of Parts basis, displays its true value.

- ✦ Unlike most stocks listed on the CSE, we are bullish on the outlook for AHUN as in our view the company has moved far beyond being a Sri Lankan Hotel company to becoming a largely regional or at least Maldivian hotel operator with some very limited exposure to Sri Lanka.
- ✦ To fully reflect the value of the company's overseas operations we have done a preliminary valuation of the company on a "Sum of Parts basis" valuing the operations in different regions separately.
- ✦ We believe the existing Maldivian operations alone are at an 13% premium to the price the stock is trading at today. This valuation is based on a Sri Lanka discount rate of 24%.
- ✦ However as its operations in the Maldives can essentially be looked as been operations merely managed by a company domiciled in Sri Lanka with near zero exposure to Sri Lanka risk factors, a choice of lower international discount rates would lead to a further valuation upside.
- ✦ In addition to this, in our view the Sri Lanka hotel operations have a value of at least Rs.31.37 per share on very conservative assumptions on realisable asset value. The sum of the separate valuation of the existing Sri Lanka and Maldivian operation is Rs.96.92 per share.



Valuation does not take into account value of Indian Management contracts or potential new investments and opportunities.

We have not incorporated any value to other hotel investment and management opportunities the company could likely 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.

Valuation of the existing Maldivian Operations.

- For the financial year ended 31st March 2007 AHUN Maldivian operation generated a profit before tax and minority interest of Rs.695Mn this was an increase of 51% YOY.
- To value these operations we looked at a discounted cash flow valuation methodology as AHUN has a finite lease period on these resorts that are generating these revenues.
- As such a comparative relative based valuation in our view would be inappropriate; we estimated cash flows to the AHUN from these resorts during the remaining lease period and discounted the cash flows by 24%.
- Cash flow growth in the base case scenario was projected at 10%, just 2% above our long term expectations for dollar appreciation.
- 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.
- Based on these assumptions the Maldivian sector alone provides a valuation of Rs.65.52 per share.

- Underneath is a sensitivity table of the value per AHUN share of its Maldivian operations under varied assumption

Discount Rate	Growth Rate above the 8% projected SLR Depreciation against Dollar					
		0%	1%	2%	5%	8%
	15%	87.50	92.61	98.11	117.40	141.87
20%	69.84	73.45	77.31	90.65	107.19	
24%	59.69	62.51	65.52	75.78	88.30	
25%	57.55	60.22	63.05	72.70	84.43	
28%	51.89	54.16	56.55	64.66	74.39	

Using Dollar Cash flows and discount rates raises the value of Maldivian Operations to Rs74.16

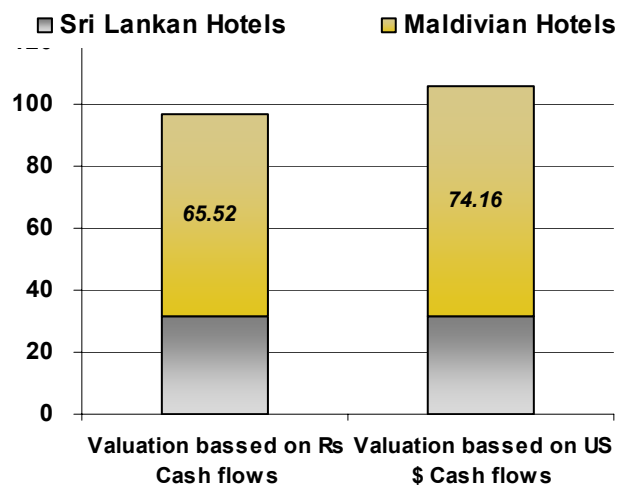
- The dominant non Sri Lanka exposure of the counter allows us the option of valuing the non Sri Lankan Cash flow on international discount rates and risk premiums and as such serves to mitigate the issue of very high real interest rates depressing equity valuations in Sri Lanka.
- The base case growth rate in this scenario was 2% in USD terms while we took a equity discount rate of 12% which is based on a 4.8% USD risk free rate and a 7.2% risk premium.

Based on the above assumptions the base case value of Maldivian operation rises to Rs.74.16 per AHUN share. Our Fair Value for the entire company and target price however is based on the lower valuation derived through the Sri Lanka Discount Rate.

Discount Rate	Growth Rate					
		0%	1%	2%	5%	8%
	10%	73.48	77.39	81.58	96.09	114.18
12%	67.14	70.53	74.16	86.65	102.09	
15%	59.25	62.04	65.01	75.15	87.50	
20%	49.27	51.35	53.56	60.98	69.84	
24%	43.26	44.96	46.74	52.69	59.69	

➤ However even using Sri Lankan discount rates for its overseas cash flow we find the counter very attractive as the cash flows are of a much shorter duration than that of most investments given that the islands are typically handed back to the Maldivian owner at the end of the contract.

➤ Given that there is no continuing value, and the lower relative duration of expected cash flows the valuation discount on account of high real interest rate is lower than for most other equity investments in which long term cash flows and terminal values are discounted at very high rates.



Using relative valuations such as PE or Book value for Maldivian Operations would be misleading.

An alternative but inappropriate valuation of the companies Maldivian operations would be to look at relative PE or book value based valuation. However given that the lease on the islands are for finite periods in our view such a valuation would be misleading as comparisons would be with assets which have much longer potential time frame of operations.

Valuation of Sri Lankan Operations.

As the Sri Lankan operations are currently generating significant negative cash flows, and a discounted cash flow approach would be very sensitive to assumptions regarding the timing of a return to peace, we looked at an adjusted book value based approach to the Sri Lanka operations.

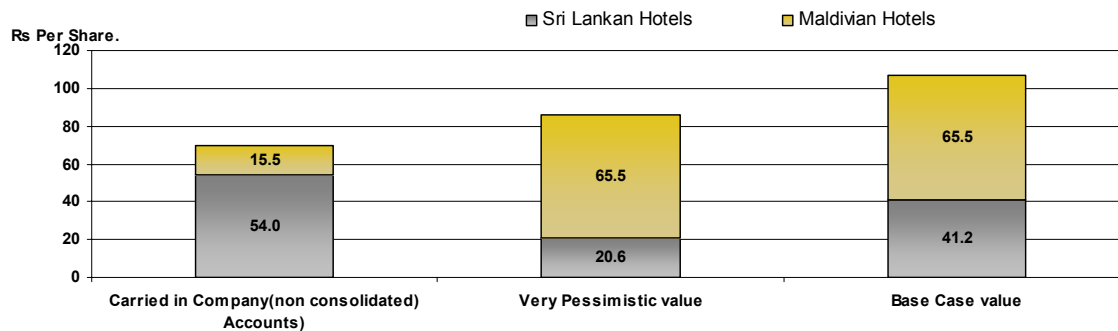
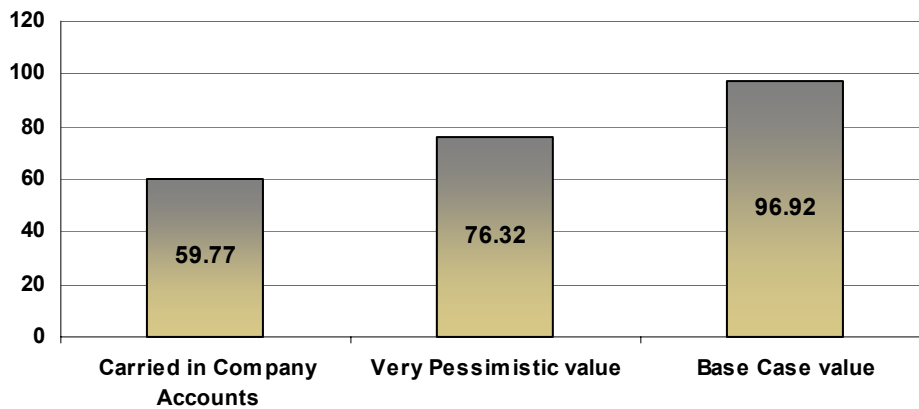
- ✦ We took extremely pessimistic assumptions in one case in our Sri Lanka valuation, while for the base case we looked at it from a still pessimistic but more realistic value for the Sri Lanka Hotels. Both these valuations are a substantial discount to new building or a replacement cost approach value for the hotels.
- ✦ The alternative option to value the Sri Lankan operations were to value it based on the value they are now carried on books of AHUN.

In whatever case we take it as a given that the value of Sri Lanka operations is a positive figure, as if it were a negative figure the option exists of a abandonment options or sale at least for the land value. It is in fact the fact that Sri Lankan operations are not negative that highlight the true value of the Maldivian operations. The typical consolidated relative value approach that is taken to a company like this that has one segment generating negative cash flows tends to hide the positive value of the profitable segment.

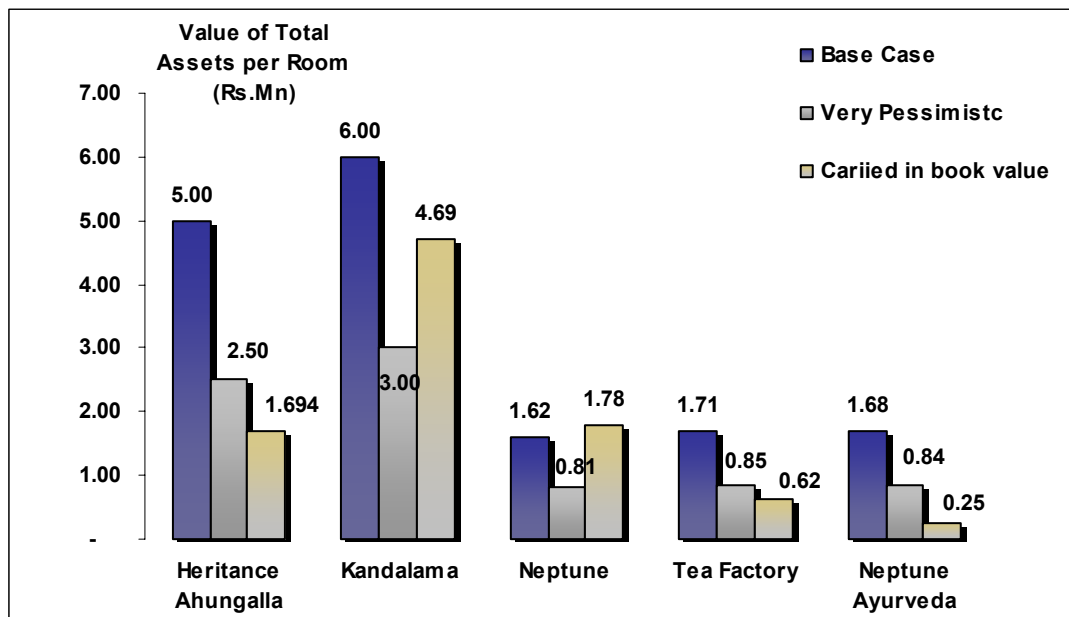
Underneath is the valuation derived under the three assumption sets where are base case value adds up to Rs96.92 and our very pessimistic valuation of Sri Lanka Hotels the value adds up to Rs76.3. On the Company books on a non consolidated basis, looking at the subsidiaries just as investments, the book value per share comes to Rs56.8 while on a Consolidated it comes in over Rs80 per share.

	<i>Carried in Company(non consolidated) Accounts</i>	<i>Very Pessimistic value</i>	<i>Base Case value</i>
Sri Lankan Hotels	54.0	20.6	41.2
Maldivian Hotels	15.5	65.5	65.5
Adjustments	-9.8	-9.8	-9.8
Total	59.8	76.3	96.9

Total Value per Share



Underneath is a Chart providing our underlying basis of Valuation per room taken in the Very Pessimistic and Base Case Value and compared to what it is implied at based at the cost it is carried in the company accounts on a non consolidated basis.



Financial review For the Quarter ended 30th June 2007

For the quarter ended total group revenue increased 71% QOQ. In the first quarter Maldivian and other foreign sector revenues increased by 74%. The revenue growth of the Sri Lankan sector was a healthy 57% with Hotels that were closed for refurbishment last year being open this year. Profitability wise the total group loss recorded a decrease of 76% YOY. The loss from the Sri Lankan sector decreased by 34% whilst the profits from the Maldivian and other resorts showed a slight decrease of 7%. Even though the Sri Lankan sector results have shown considerable positive upturn we remain pessimistic of the future potential of the growth in the Sri Lankan tourism sector in the



near future. We remain positive regarding the Maldivian sector growth potential even with the slight set back in profitability in the Maldivian sector QoQ.

Appendices

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

Company Profile

Ahungalla Hotels Ltd was incorporated in 1978 as a public quoted company. The company grew over the period of time with the commencement of commercial operations of Triton Hotel and 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., investment in Browns Beach Hotel and Hotel Hillop. 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 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 ventures 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

- **Heritage Kandalama**-Managed to generate a healthy operating profit despite the depressed tourist arrivals, but the growth in the revenue of
- **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 scenarios recorded a 15% growth in revenue and an increase of 34% in operating profit.
- **Neptune Ayurveda Hotel**-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 a 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 the last year and this is a consequent of the growth in the Maldives 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% with the 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** is the former Lohifushi resort was launched in November 2006 and it has generated impressive results during its shorter operating period.

As 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 next financial year while other two resorts might commence the operations in the following financial year.

Operational Review - 2006/2007

- Despite the fluctuations experienced by the group in trading results over the decade, in 2007 the group recorded a profit after tax of Rs.380 Million, which is an increase of 240% compared to the previous financial year.
- The revenue generated by the group also increased tremendously over the period of time and recording a Rs.4,300 Million which shows an increase of 67.93%.
- The Maldives sector contributed for 84% of group revenue while the Sri Lankan sector contributed only 16%.
- The total revenue segment of the group comprises of room sales, food& beverage, guest transfers, diving, excursions, rent and shop income.
- Out of the above segments the room sales and food& beverage contributed for 49% and 27% respectively for the total revenue.
- The improved trading result in 2007 is resulted from the significant overseas expansions in particular to the Maldives Islands.
- The Maldives sector led by the Group's flagship property, Adaaran Select Meedhupparu accounted immense growth during the year with a profit of Rs.695 Million, a 51% increase over the previous year.
- The Sri Lankan operations of course didn't generate the expected favourable results except for the modest profits generated by Heritance Kandalama and Neptune Ayurvedic Village.
- Also the over all operational loss coupled with the substantial increase of interest expenses for the refurbishment of Heritance Ahungalla and Heritance Kandalama.

According to the Chief Executive, *““Heritance” the newly conceptualized brand- is a blend of two propositions of Heritage and Inheritance, two factors that have been intrinsically a part of the Aitken Spence service offer”.*

Financial Review 2006/2007

- Purely from financial stand point the Return on average Shareholder's funds has fallen during the financial year under review despite the growth in the profit after taxation.
- This is evident from the Group's rising focus on increasing the reserves of the organization and increasing the retained profit for the utilization on future expansions to markets like India.
- Next when we consider the asset turnover of the organization, which emphasizes on the level of efficiency of the company's operations, the ratio seem to be growing aggressively over the period of time. Especially in 2007 the asset turnover is 48.9% when compared to the asset turnover of 38.9% in 2006. Therefore the asset utilisation seems to be increasing.
- The compounded annual growth rate of the organization seems to be 17.8% over the decade starting from 1998.
- Since the Company's gearing increasing consistently, which is attributable from the debt equity ratio of the Company and this has caused the negative consequence of decrease in interest cover.
- In 2007 the interest cover has dropped to 2.62 times which is the lowest during the last five years. This can be caused by the higher interest expenses incurred by the Company for the refurbishment work at Heritage Ahungalla and Heritage Kandalama.

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