October 31, 2018

FAIR VALUE: **32**

CURRENT PRICE: **42.60**

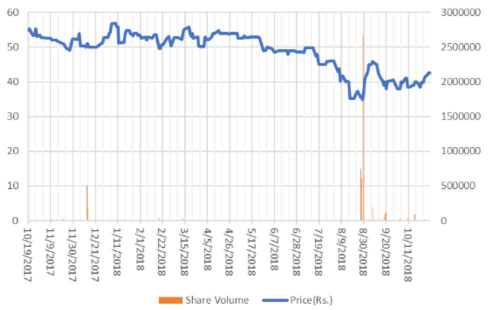
Asian Hotels & Properties PLC (AHPL)

Price target	LKR 32
Current Price	LKR 42.6
52-week range	LKR34.8-56.8
Market capitalization	LKR 18.9bn
Public float	20%
Average daily turnover	LKR 0.96m

YTD Performance	
ASPI	-7.1%
Sector	-5.7%
AHPL	-75.8%

Year End 31-Mar	FY17	FY18	FY19e	FY20e
EPS (Rs)	5.1	3.8	2.9	3.6
DPS (Rs)	4.00	1.50	1.50	1.50
NAVPS (Rs)	82.5	79.6	80.5	82.9
P/E (x)	8.3	11.2	14.9	11.8
P/BV (x)	0.5	0.5	0.5	0.5
Div. Yield (%)	9.4	3.5	3.5	3.5
Div. Payout (%)	78.2	39.4	52.5	41.5
ROE (%)	6.2	4.8	3.5	4.4
EBITDA margin (%)	33.0	26.6	22.8	25.6

AHPL: 52 week price/volume chart



Source: CSE, Taprobane Research

In valuation doldrums

Asian Hotels & Properties (AHPL) is the holding company for two high end city hotels, namely, Cinnamon Grand and Cinnamon Lakeside. In addition to city hotels, AHPL was also a property developer, when it developed and marketed two high end residential apartment complexes. AHPL is a subsidiary of John Keells Holdings (JKH) and forms a key part of the JKH group's leisure sector exposure. Annual average occupancy level has hovered at around mid-60% range over the last 2-3 years, broadly in line with peers. Average room rate (ARR) has averaged between USD125-135, which is in line with the minimum room rate set by the Government of Sri Lanka for the city hotels category. We expect the minimum floor rate for ARR to continue over the next 2-3 years, due to substantial pressure from the hotel sector which favours the status quo. We expect AHPL to face stiff competition from newer hotels, sporting global brand names. Moreover, Business and MICE related tourism, which are key drivers for AHPL are still underdeveloped. With some tailwind from LKR depreciation, we expect EBITDA margins to hover at around the 23-26% range over our forecast period. Nevertheless, the current political instability does not augur well for business confidence and investment climate. We feel, AHPL is currently trading at a premium cf. our DCF based price estimate. We recommend SELL.

Business confidence and Investment flows remain sluggish: We believe that as an operator of city hotels catering to the business tourism segment, Business confidence and FDI are key revenue drivers. Business and MICE related inbound travel have declined relative to the leisure segment over the past decade. Moreover, the current political instability and associated risks certainly do not augur well for the business and investment climate in Sri Lanka. Against this backdrop it is difficult to envisage Sri Lanka being considered as a destination for big ticket MICE events.

Competition from new hotels; floor rate counter-productive: AHPL should face stiff competition from newer hotels carrying globally recognized brand names (e.g. Shangri-La, Sheraton etc.). City hotel room inventory has more almost doubled since 2009 and over a 1,500+ additional rooms are expected over the next 2-3 years. The regulated floor rate on room charges should adversely impact AHPL's pricing strategy. Moreover, the floor rate can also adversely impact MICE tourism.

Steep valuation: Based on a DCF valuation (CoE-18%, g-3%), we estimate AHPL's 12-month Target Price at Rs.32/share which is a c.33% premium. AHPL is currently trading at c.18x FY20E PE indicating that valuations have gotten ahead of earnings cf. the market. Though, on a replacement cost basis, we estimate AHPL's share price at c.Rs.75, this is merely in our view a theoretical exercise with little impact on a portfolio investor. We recommend SELL**.**

YE 31 March (Rs m)	FY17	FY18	FY19e	FY20e	FY21e	FY22e
Revenue	9,067	8,628	8,568	9,749	10,424	11,158
EBITDA	2,993	2,292	1,950	2,493	2,783	3,040
PBT	3,086	2,469	1,880	2,386	2,688	2,370
PAT	2,265	1,686	1,265	1,600	1,817	1,588
EPS (Rs)	5.1	3.8	2.9	3.6	4.1	3.6
NAVPS (Rs)	82.5	79.6	80.5	82.9	85.7	88.1
EBITDA margin (%)	33.0	26.6	22.8	25.6	26.7	27.2
EV/EBITDA (x)	7.2	9.4	11.1	8.7	7.8	7.1
PER (x)	8.3	11.2	14.9	11.8	10.4	11.9

Source: Company Data, Taprobane Research

Flagging business confidence and sluggish FDI stunt business travel: Sri Lanka's overall business confidence indices as well as FDI inflows have been performing poorly over the last few years. With AHPL catering mainly to the business travel and MICE segment, we feel that that this would not support topline growth over the next 2-3 years, especially in the context of the prevalent political situation. Sri Lanka has slipped several notches in the World Bank's global Ease of Doing Business Index ranking, slipping from 83 in 2013 to 111 in 2018. In addition to this, FDI inflows have stagnated, partially as a result of the weak domestic political and economic environment as well as due to global economic uncertainty. FDI flows have been mostly toward key government led infrastructure projects; foreign private capital inflows to industry and enterprises have been slow.

Business & MICE travel have consistently been under developed

Source: SLTDA, Taprobane Research

MICE and business travel are relatively underdeveloped: Business and MICE related travel as a percentage of total tourist arrivals have declined over the last decade. This can be attributed to increased focus on leisure travel, which has consistently been supported by the Government and the Leisure industry. Nevertheless, regional free trade agreements may provide some fillip to the business travel and MICE segment. Based on ICCA statistics, though Sri Lanka's ranking as a MICE host has improved in the Asia Pacific and Middle East region, it still lags key regional peers such as India and Singapore. Moreover, the number of events held has not improved significantly over the last decade.

Though Sri Lanka's ranking has improved, it still lags key regional peers

	Sri Lanka		India		Singapore	
	Rank	No of events	Rank	No of events	Rank	No of events
2017	18	19	5	175	7	160
2016	18	25	7	143	6	151
2015	19	18	7	151	5	156
2014	16	31	9	116	1	142
2013	18	17	6	142	5	175
2012	73	14	5	150	6	150
2011	82	10	8	105	5	142
2010	74	11	16	100	6	136
2009	86	7	33	91	5	119
2008	71	9	31	92	21	118

note: ranking amongst Asia Pacific and Middle East destinations

Source: ICCA, Taprobane Research

Competition from newer hotels and MICE venues can dent performance

Competition from newer hotels and conference venues: AHPL's hotel properties are both well over three decades old, but have undergone substantial periodic refurbishment. Though these hotels retained pole position amongst Colombo's city hotels a few years back, the advent of newer city hotels with global brand names (e.g. Shangri La, ITC-Sheraton, Movenpick etc.) should pose a serious challenge to AHPL. City hotel room inventory has continued to increase over the past decade from 3.209 rooms in 2009 to 5,310 rooms in 2017. We estimate c.1,500 new rooms inventory in the luxury star class category to come online over next two years. In addition to this, new nigh end convention and conference venues such as JKH's own Cinnamon life integrated resort cane easily attract high value MICE events.

Developer	Brand	Location	Positioning	Status	Year	Keys
Fairway Holdings	Zmax Fairway	Colombo Fort	Economy	Completed	2016	196
Jetwing Hotels	Jetwing Colombo 7	Ward Place	Midscale	Completed	2016	90
Premier Pacific	Sheraton	Galle Road	Upscale	Under construction	2016	306
Damro	Marino Sands	Colombo	Midscale	Completed	2018	270
Softlogic	Moevenpick	Kollapitiya	Upscale	Completed	2016	180
Shangri-la	Shangri-la	Galleface Green	Luxury	Completed	2017	500
John Keells Group	Cinnamon Life	Glennie Street	Luxury	Under construction	2019	800
Colombo City Centre	Next	Beira Lake	Upscale	Completed	2018	200
ITC Hotels	ITC Hotels	Galleface Green	Luxury	Under construction	2020	300

Source: JLL, Taprobane Research

Floor rate is counter-productive

Floor rate is counterproductive: Room rates charged by Colombo's city hotels are regulated by the government. The minimum room rate was introduced in 2009, mainly to support smaller 3 star hotels against aggressive pricing by larger luxury class hotels. This was done against the backdrop of dwindling tourist arrivals and limited room inventory. However, we feel that this has now turned counter-productive, with tourist arrivals picking up and city hotel room inventory expected to double from 2009 levels. Older hotels such as AHPL would be hard pressed to compete against newer entrants at least on pricing . Floor rates also deter the MICE segment, as most event organisers seek bulk rate pricing. As such, the both the industry and the country at large missing out on the wider benefits that MICE tourism brings in.

Benefit from LKR depreciation should be short lived

Tailwind from Currency depreciation stymied by political instability and weak economic: The recent slump in the LKR should have a positive impact for AHPL's topline, since room rates are priced in USD. However, it is worth noting that room revenue only accounts for c.50-60% of total revenue. Other revenue lines such as F&B are priced in LKR. Moreover, the prevailing political impasse, weak business confidence and investment climate may dampen profitability. It is also important to note that, given that LKR depreciation has a pass through impact on domestic price levels, input cost inflation can rise, albeit after a 6-9 month lag and eventually erode any margin benefit gained from LKR depreciation.

Steep Valuation. SELL

Steep Valuation: Our DCF model yields a 12 Month Target Price of Rs.32/share (CoE 18%, g-3%). AHPL is trading at a FY2020E PE (based on recurring EPS) of c.18x which we feel is expensive cf. the market. On a replacement cost basis, we estimate the construction cost of a 5 star luxury hotel would average at c.Rs35,000 per sq.ft. This translates to a replacement cost of c.75/share for a hypothetical hotel, comparable to AHPL, including lease cost of land. Nevertheless, we feel that this is merely a theoretical exercise with little value for a portfolio investor. This further validates our view, that AHPL can only see a valuation upside on any potential corporate action, the subject of which is beyond the scope of this report. In addition, significant downside risks remain from political instability and sluggish growth in business and MICE travel. We recommend SELL.

Income statement

YE 31 March (Rs m)	FY17	FY18	FY19e	FY20e	FY21e
Revenue	9,067	8,628	8,568	9,749	10,424
Operating Profit	2,494	1,774	1,270	1,818	2,111
Net finance cost	193	117	33	-9	-1
Revaluation	399	578	578	578	578
PBT	3,086	2,469	1,880	2,386	2,688
Net Profit	2,265	1,686	1,265	1,600	1,817
EPS (Rs)	5.1	3.8	2.9	3.6	4.1
Net Profit - Recurring	1,866	1,108	687	1,022	1,239
EPS (Rs) - Recurring	4.2	2.5	1.6	2.3	2.8

Balance Sheet

YE 31 March (Rs m)	FY17	FY18	FY19e	FY20e	FY21e
Property, Plant & Equipment	30,396	32,879	32,706	32,509	32,348
Leasehold properties	781	769	757	744	732
Investment properties	4,565	5,167	5,751	6,329	6,906
Other non current assets	44	49	49	49	49
Non Current Assets	35,787	38,864	39,262	39,630	40,035
Receivables	651	834	839	732	789
Inventories	149	164	238	259	278
Other current assets	386	228	347	347	347
Short-term deposits	1,584	704	924	924	924
Cash and cash equivalents	636	353	174	762	1,587
Current Assets	3,405	2,284	2,522	3,024	3,924
Long Term Borrowings	256	146	36	0	0
Employee Benefit Liability	306	345	354	354	354
Deferred Tax Liabilities	346	3,614	3,614	3,614	3,614
Long term liabilities	909	4,106	4,003	3,967	3,967
Trade and other payables	531	759	990	948	1,019
Loans and borrowings	114	146	143	37	0
other current liabilities	1,130	900	1,015	1,015	1,015
Current Liabilities	1,775	1,805	2,148	1,999	2,033
Share Capital	3,345	3,345	3,345	3,345	3,345
Reserves	29,764	28,393	28,783	29,719	30,871
Minority Interest	3,400	3,499	3,506	3,624	3,743
Equity and Reserves	36,509	35,237	35,634	36,688	37,959
NAVPS	82.5	79.6	80.5	82.9	85.7

Cash Flow Statement

YE 31 March (Rs m)	FY17	FY18	FY19e	FY20e	FY21e
PBT	3,086	2,469	1,880	2,386	2,688
Depreciation & Amortisation	545	561	680	676	673
Changes in working capital	-24	-16	156	43	-5
interest paid	0	0	48	0	0
taxes paid	0	0	-21	-5	0
other adjustments	-528	-946	-1,124	-1,237	-1,329
Operating Cash Flow	3,080	2,069	1,619	1,863	2,026
Capex	-356	-1,584	-497	-466	-500
FCFF	**2,724**	**485**	**1,122**	**1,397**	**1,527**
net debt issued/repaid	-84	-86	-128	-145	-38
FCFE	**2,640**	**399**	**993**	**1,252**	**1,489**
Dividends paid	-1,771	-1,328	-886	-664	-664
other adjustments	-337	-374	-115	0	0
Net Cash Flow	532	-1,304	-7	588	825

Source: Company Data, Taprobane Research

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