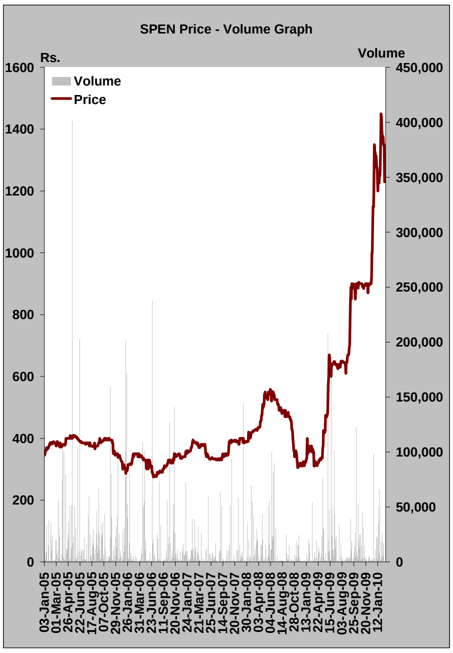
A JKSB Research Publication

Aitken Spence PLC (SPEN)

Rs. 1350.00 **BUY**



SPEN			
Reuters Code			SPEN.CM
Bloomberg Code			SPEN.SL
Share Price LKR			1,350.00
Issued Share Capital (Shares)			
Voting			27,066,403
12 mth High/Low (Rs.)			1450.00 / 309.00
Market Capitalisation (Rs.mn)			12,494
Average Daily Volume (Shares)			10,664
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	4.43	48.82	114.11
SPEN	10.20	109.38	276.04

Financial Year (Dec)	Revenue (Rs.mn)	NPAT (Rs.mn)	EPS (Rs.)	EPS Growth %	PER (x) Rs.	P/BV	Dividend Yield %	DPS Rs.	NAV / Share	ROE
2006	13,429	1,214	44.84	8.7%	30.11	4.28	0.48%	6.50	315.09	14.2%
2007	19,530	1,460	53.93	20.3%	25.03	3.68	0.48%	6.50	366.92	14.7%
2008	27,194	1,841	68.02	26.1%	19.85	3.07	0.52%	7.00	439.8	15.5%
2009	29,000	2,040	75.38	10.8%	17.91	2.14	0.70%	9.50	631.0	11.9%
2010E	31,064	2,129	78.65	4.3%	17.16	1.93	0.70%	9.50	700.1	11.2%
2011E	35,134	3,173	117.25	49.1%	11.51	1.67	0.70%	9.50	807.9	14.5%
2012E	38,412	3,711	137.09	16.9%	9.85	1.44	0.70%	9.50	935.5	14.7%

- Aitken Spence has continued to expand its presence in the leisure sector in the region while upgrading its properties in Sri Lanka and is now well positioned to take advantage of the anticipated renaissance in the Sri Lankan tourism sector following the end to the war.

- In addition a consortium made up of Aitken Spence and China Merchants Holdings were the sole bidder for the new container terminal at the Colombo Port. Final consent on granting this consortium approval to design and build what is expected to be 2.4mn containers a year facility is still pending. It is unclear as to what Aitken Spence's stake is of the consortium as well as how the company intends to finance the investment.

Leisure

- The leisure sector experienced a challenging period in the last financial year with an escalation in the conflict in Sri Lanka as it neared an end and a global downturn adversely affecting arrivals and room rates in both Sri Lanka and Maldives. Higher finance costs in Sri Lankan operations as well as an incremental rise in operational costs resulted in depressed margins.

- However with the opportunities peace in Sri Lanka has presented to the group and an expected global recovery next year, the leisure sector is well positioned to spearhead earnings growth over the medium term.

Leisure - Sri Lanka

- Low occupancy levels and drop down room rates which were a common feature in the tourism industry over the last 3 decades is expected to reverse over the next few years with the industry on the threshold of unprecedented growth.

- Aitken Spence operates 7 resort hotels in the country with a total of 681 rooms in the country a bulk of which are upper range rooms. The company boasts some of the best resort properties in the country with three of its premier Sri Lankan properties in the southern cost, the cultural triangle and the hill country being re-furbished and re-branded under the heritance brand. The revival of the North and East also offers the company to capitalize on the groups' prime block of beach front land in Nilaveli, Trincomalee.

Yolan Seimon
yolan@jkstock.keells.com

John Keells Stock Brokers (Pvt) Ltd
Company No. PV 89
130, Glennie Street,
Colombo 2,
Sri Lanka.

Tel: 9411 2421 101-9 (Gen.),
9411 2326 003,
9411 2439 047/8

Fax: 9411 2326 863,
9411 2342 068

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- The groups' traditional market for high end tourists from the west declined in the last financial year with tourist arrivals declining on account of the global economic downturn which was exacerbated by an intensified conflict over the prime winter season. Budget tourists with shorter average days spent increased, and promotions targeted at domestic traveler did reap some positive results, yet this was insufficient to offset a loss in earnings on account of depressed ARR's and lower occupancy levels in the key 2008/2009 winter season.

- The end of the war and the dawn of peace in the country is expected to result in a resurgence in tourist arrivals in FY10 with occupancy levels conservatively expected to average at 58% in FY10 as a result of a poor 1H increasing to 72% in FY11. ARR's are forecast to amount to US$ 72 in FY10 increasing to US$84 in FY11 and US$ 93 in FY12. Sri Lankan resort operations are expected to post an EBIT of Rs. 690mn in FY10 and 1,145 in FY11 as a result of an expected increase in occupancy from the 3Q FY10 and an increase in room rates FY11. The likely requirement of additional hotel rooms in the country over the next 5 years and beyond should see the group investing in developing further properties like the prime beach front land in Nilaveli, Trincomalee.

Leisure - Maldives

- The Groups operations in the Maldives have consistently propped up the company's tourism sector in the midst of a volatile Sri Lankan market. The groups 7 Maldivian properties were repositioned under the Adaaran brand in 2008 with the group operating 591 rooms with total bed strength of approximately 1600 in the archipelago. The group has successfully pioneered the resort within a resort concept in the country catering to a cross section of travelers in the 4 star, wellness, and 5 star boutique holiday maker categories. The addition of the high end 5 star boutique holiday resorts in particular have increased yields.

- The group divested from its first island resort Adaaran Club Bathala in the last financial year but also saw the completion of Adaaran Prestige Vadoo consisting of 50 high end water villas as well as 37 water bungalows on the HudhuRan Fushi island under Adaaran Prestige Ocean Villas. In addition 16 water bungalows were added to Adaaran Club Rannalhi.

- Average occupancy has consistently been in excess of 80% and is expected to increase to 85% over the medium term with ARRs' conservatively expected to grow by 5% from FY11 onwards. Average blended room rates for the groups' Maldivian operations are estimated at approximately US$ 300mn compared to a current average of US$ 72 in Sri Lanka. Maldivian resort operations are expected to yield an EBIT of Rs. 493mn in FY10 and Rs. 1,063mn FY11.

Leisure - Management of Indian and Oman hotel properties

- The company has signed an agreement to manage 5 hotels of the Oman Hotels and Tourism Company including a luxury desert camp added in 2008 two hours away from the capital Muscat with 30 luxury Bedouin style tents. The other 4 hotels also include the 4 star 143 room Al Falaj hotel and the 3 star 105 room Ruwi Hotel located in Muscat. The two other resorts include the 54 room 3 star Al Wadi Hotel located 210km from Muscat and the 108 room Sur Plaza Hotel located in the city of Sur along the country's northern coast and in close proximity to Turtle Beach.

- Tourist arrivals in Oman are expected to rise from 1.8mn in 2007 to 6mn by 2012 with the World Travel and Tourism council estimating that Oman's tourism sector would grow to US$ 8bn in 2018 from US$ 2.5bn in 2008. Aitken Spence currently has 4 hotels under management in India, them being, 'Barefoot at Havelock' a resort in the Andaman Islands, the 78 room Poovar Island resort in Kerala which also houses a 20 Deluxe Cottage Ayurveda Village, a 5 Star Deluxe Hotel branded as Heritance Madurai in Tamil Nadu with 47 rooms including 35 luxury pool villas, and a 60 room 4 star property named Atithi in the southerm coast off Chennai.

- The terms of the management agreements for the properties managed in India and Oman have not been disclosed by the company and as such, potential contribution to earnings is difficult to ascertain.

Strategic Investments

- Spence owns and operates 3 thermal power plants, the largest of which, the 100MW Ace Power Embilipitiya power plant was built in partnership with Caterpillar and commenced commercial operations in early FY06. The company has recently discontinued an external management agreement of the plant and is now internally managed resulting in savings on operation and maintenance. The Power Purchase Agreement with the state utility CEB is expected to expire in FY16. The company also operates two 20MW Power Plants in Matara and Horana with a 10 year Power Purchase Agreement expected to expire in April and December 2012 respectively.

- The state utility are the sole purchasers of power and the purchase agreements are for the generation and sale of energy for 10 years, which is guaranteed by an Implementation Agreement with the Government of Sri Lanka. The agreements allow for the full pass-through of fuel costs and are structured so that all three projects receive separately calculated payments for the capacity and the energy provided. The capacity payment formula accounts for the fixed operating costs and interest costs and is paid irrespective of the amount of energy purchased.

- It is uncertain as to whether these PPA's will be renewed since several large state owned plants currently under construction such as the 150 MW Hydro Upper Kotmale Power Plant and the 300 MW Norochcholai Coal Power Plant are expected to be completed by end 2011. The country had an installed capacity of 2645MW as of 2008 with 33.5% being attributed to Private Power Producers while Private Power Producers accounted from 41.5% of total gross generation in 2008. Currently 83% of the population has access to the national grid while demand for power grows at an estimated 8% per year, notwithstanding the likely accelerated demand over the next few years in the North and East and across the country in general.

- The strategic investments sector which also has small investments in Garments and a Printing and Packing business is expected to collectively contribute an EBIT of Rs. 1.922bn in FY10 and Rs. 2.101bn in FY11.

Other Businesses

- The groups' cargo and logistics sector include freight forwarding, courier, integrated logistics and maritime transport businesses and is expected to contribute an EBIT of Rs. 582mn in FY10 and Rs. 640mn in FY11.

- SPEN also owns 50% of MMBL Money Transfer which gives the company exposure to the growing inward remittance market, with Sri Lankan expatriate workers accounting for US$ 2.6bn in 2008. The MMBL network has over 500 subagents and has a tie up with Western Union. Other businesses in the service sector include the operation and maintenance of its power plants, the OTIS Elevator Agency, Insurance Broking particularly related to and Marine Insurance as well as management of its commercial property. Contributions from these businesses are relatively small and would amount to an EBIT contribution of Rs. 518mn in FY10 and Rs. 595mn in FY11.

Outlook and Valuations

- The group has not raised capital from the public since FY 2000, with capital constraints limiting potential for further diversification or aggressive expansion in existing lines of business. However despite its capital constraints Aitken Spence has diversified its exposure in the leisure sector gaining a soft foot print in the potentially lucrative Indian and Middle Eastern markets while well positioned to benefit from a renaissance in the tourism sector expected in Sri Lanka following the end of the hostilities.

- It remains to be seen if the company in consortium with China Merchant Holdings will be granted approval to design and construct a new terminal at the Colombo Port, and if so the terms and earnings potential of the project.

- At 11.51x earnings for FY11E at a market price of Rs. 1,350/- the counter is at a 8.6% discount to the conglomerate sector and market. Despite the illiquidity of the share we believe that such a discount is unwarranted given its heavy exposure to the key growth sectors of leisure and transportation. We recommend **BUY**

INCOME STATEMENT FOR THE YEAR ENDED 31ST MARCH	2008 Rs. 'mn	2009 Rs. 'mn	2010E Rs. 'mn	2011E Rs. 'mn	2012E Rs. 'mn
Revenue					
Leisure	6,995	7,398	9,531	12,138	13,833
Strategic Investments	16,158	16,977	16,376	17,243	18,160
Cargo and Logistics	3,282	3,235	3,559	3,914	4,306
Services	759	1,390	1,599	1,838	2,114
Total Revenue	27,194	29,000	31,064	35,134	38,412
Operating Profit					
Leisure	1,258	1,264	1,259	2,321	2,635
Strategic Investments	1,712	1,869	1,922	2,101	2,247
Cargo and Logistics	351	529	582	640	704
Services	290	450	518	595	684
Total Profit from Operations	3,611	4,112	4,280	5,657	6,270
Net finance income / (expense)	(679)	(706)	(669)	(648)	(579)
Share of assocaite companies profit / (loss)	132	(9)	64	78	87
Profit before tax	3,065	3,397	3,675	5,087	5,779
Income tax expense	(235)	(328)	(336)	(429)	(483)
Net profit for the period	2,829	3,069	3,339	4,658	5,296
Minority Interest	989	1,029	1,210	1,485	1,585
Profit attributable to shareholders	1,841	2,040	2,129	3,173	3,711

BALANCE SHEET AS AT 31ST MARCH	2008 Rs. 'mn	2009 Rs. 'mn	2010E Rs. 'mn	2011E Rs. 'mn	2012E Rs. 'mn
ASSETS					
Non Current Assets					
Property Palnt and Equipment	16,982	22,636	21,865	21,094	20,323
Leasehold property	1,357	1,505	1,505	1,505	1,505
Intangible Assets	123	109	98	88	80
Investment Property	29	29	29	29	29
Investment In Associates	764	753	806	874	951
Long Term Investments	264	405	405	405	405
Deferred Tax assets	39	74	78	84	89
	19,558	25,510	24,786	24,079	23,382
Current Assets					
Inventories	1,305	1,284	1,375	1,757	3,457
Trade and Other Receivables	6,085	5,834	5,959	9,262	10,966
Amounts due from associates	116	161	150	125	105
Current Investments	5	5			
Deposits and Pre-payments	482	533	570	645	705
Current Tax receivable	18	57			
Short term deposits	2,597	2,020	2,164	2,448	2,676
Cash and cash equivalents	859	828	2,048	1,700	1,382
	11,465	10,721	12,266	15,937	19,292
Assets classified as held for sale	162	149	-	-	-
Total Assets	31,185	36,381	37,052	40,016	42,673
EQUITY AND LIABLITIES					
Equity Attributable to Shareholders					
Stated Capital	2,135	2,135	2,135	2,135	2,135
Reserves	3,505	7,228	7,228	7,228	7,228
Retained Earnings	6,264	7,715	9,588	12,505	15,959
	11,904	17,078	18,950	21,867	25,321
Minority Interest	3,882	4,553	4,553	4,553	4,553
Total Equity	15,786	21,631	23,504	26,421	29,875
Non Current Liabilities					
Interest bearing liabliities	6,508	6,241	5,982	5,742	5,502
Deferred Tax Liabilities	187	198	210	225	243
Employee benefits	209	238	263	288	313
	6,904	6,677	6,454	6,255	6,058
Current Liablities					
Trade and Other Payabels	3,782	3,909	3,106	3,513	3,073
Interest Bearing liabilities repayable within one year	2,106	1,866	1,495	1,435	1,375
Amounts due to associates	4	1	-	-	-
Current tax payable	93	135	-	-	-
Interim dividend declared	81	-	-	-	-
Short term bank borrowings	2,429	2,162	2,492	2,392	2,292
	8,496	8,072	7,094	7,341	6,741
Total Liabilities	15,399	14,749	13,549	13,596	12,799
Total Equity and Liabilities	31,185	36,381	37,052	40,016	42,673

CASHFLOW STATEMENT FOR THE YEAR ENDED 31ST MARCH	2008 Rs. 'mn	2009 Rs. 'mn	2010E Rs. 'mn	2011E Rs. 'mn	2012E Rs. 'mn
Net profit Before Tax	3,065	3,397	3,675	5,087	5,779
Net cash generated from / (used in) operating activities	1,627	3,896	2,901	1,652	1,589
Cash Flow from Investing Activities					
Investments made during the year	(104)	(141)	-	-	-
Purchase of property plant and equipment	(1,654)	(3,799)	(500)	(500)	(500)
Purchase of leasehold rights	(1,402)	(64)	-	-	-
Proceeds from sale of property plant and equipment	307	362	-	-	-
Proceeds from sale of investments	48	247	-	-	-
Proceeds on retirement of assets held for sale	-	13	149	-	-
Dividends by subsidiary companies to outside shareholders	(421)	(524)	(524)	(524)	(524)
Dividends received from associate companies	19	3	10	10	10
Net cash used in investing activities	(3,208)	(3,904)	(865)	(1,014)	(1,014)
Cash flow from financing activities					
Interest received from deposits	417	419	328	309	338
Proceeds from interest bearing liabilities	2,348	1,273	800	700	700
Repayments of interest bearing liabilities	(1,935)	(2,026)	(1,100)	(1,100)	(1,100)
Issue of shares by subsidiaries	-	25	-	-	-
Dividends Paid	(176)	(189)	(257)	(257)	(257)
Net cash used from / (used in) financing activities	654	(498)	(228)	(347)	(318)
Net inc./(dec.) in cash & cash equivalents at beginning	(927)	(505)	1,808	291	257
Cash and cash equivalents at the beginning of the period	2,119	2,774	2,276	2,048	1,700
Cash and cash equivalents at the end of the period	2,774	2,276	2,048	1,700	1,382