Stock Market Review

IHI expecting strong recovery in operational performance

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In the 2011 annual report sent to all shareholders ahead of next week's annual general meeting, the chairman of International Hotel Investments plc Alfred Pisani describes 2011 as a "momentous and positive year for IHI".

The chairman explains that this was due to three factors, namely (i) the completion and opening of the Corinthia Hotel London; (ii) the Libya crisis and the success in maintaining the hotel in Tripoli safeguarded and operational throughout the conflict; and (iii) the improved performances of the hotels across Europe.

Although over the years IHI have successfully expanded its property portfolio and developed Corinthia into a global brand, the operational performance of the various properties is an important factor which sometimes goes unnoticed.

A key financial metric used in many sectors, including the hospitality one, is the level of earnings before interest, tax, depreciation and amortisation (EBITDA). A review of IHI's EBITDA generation since 2008 reveals two important observations: (i) the importance of the Libya hotel to the overall performance of the IHI Group and (ii) the downturn in the hotel performances arising from the onset of the international financial crisis in late 2008.

These are important considerations when analysing the 2011 financial performance of the IHI Group and also in the context of management's expectations for 2012. IHI's managing director Joseph Fenech explained in the 2011 annual report that overall Group EBITDA of €22.38 million in 2011 including the rental income from the non-hotel assets was only €0.48 million below the level achieved the previous year. Both the chairman as well as the nanaging director describe this as a remarkable performance in the context of the "financial and economic crisis hitting the eurozone countries which are the main feeder markets to the hotels in various cities in Europe and North Africa" and the difficult conditions for the Libyan property with eight months of war and conflict. Mr Pisani commented that the attainment of an operating profit for the hotel in Tripoli "in these difficult circumstances is a major feat in its own right".

In a recent meeting with the financial community, Mr Fenech gave a more detailed breakdown of the group operating performance indicating that IHI suffered a €6.3 million downturn in Libya in 2011 but still managed to generate EBITDA of €3.8 million from the Libyan hotel property in spite of the situation in the country. On the other hand, he explained that the setback in Libya was mainly compensated by the improved profitability of all other properties owned by IHI with a combined increase of €4.6 million in EBITDA. Mr Fenech singled out the properties in St. Petersburg, Lisbon and Prague as these hotels all registered increased occupancy levels and improved average room rates.

Some investors may find this surprising given the wider economic backdrop across the region. However, this is partly as a result of the new online distribution system which IHI invested heavily in during 2010 to promote the Corinthia brand and achieve higher direct bookings ahead of the launch of the London hotel. In the annual report, Mr Pisani indicated that the Corinthia reservation system generated eight per cent of the bookings during 2011 and this is expected to exceed the 20 per cent level in the coming years on continued investment in online marketing.

The 2011 performance of IHI was also impacted by the initial loss incurred from the property in London following the gradual soft opening during the year and the high level of pre-opening expenses normally associated with such properties. This loss is not included in the €22 million Group EBITDA since the London property is 50 per cent owned and therefore treated as an associate.

However, the London property is expected to be one of the major contributors to the substantial turnaround that IHI is anticipating during the current financial year. In fact Mr Pisani comments that the London hotel is "a major development success" which will "drive substantial profits" once the hotel is now fully operational.

At the recent meeting with members of the financial community, Mr Fenech indicated that the IHI Group could achieve a substantially higher level of EBITDA during 2012 when compared to the recent two years when the Group generated just over €22 million each year. This is underpinned by a significant contribution from the London hotel in its first full year of operations and also a much better performance in Tripoli arising from an increasing level of occupancy and room rates following the end of hostilities and higher visitor traffic to the country. The contribution from Tripoli is however still expected to remain below that registered prior to the conflict. This trend was confirmed by IHI in the recent Interim Statement wherein it was announced that "there has been a marked improvement in the performance of IHI-owned hotels during the first quarter of 2012 over the corresponding period in 2011". In the announcement, it was also confirmed that "the improvement is largely led by the Corinthia Hotel Tripoli which is gradually returning to a stabilised performance" and the Corinthia London Hotel which has been "registering improved performances in the first quarter of 2012 compared to the budget set for the period".

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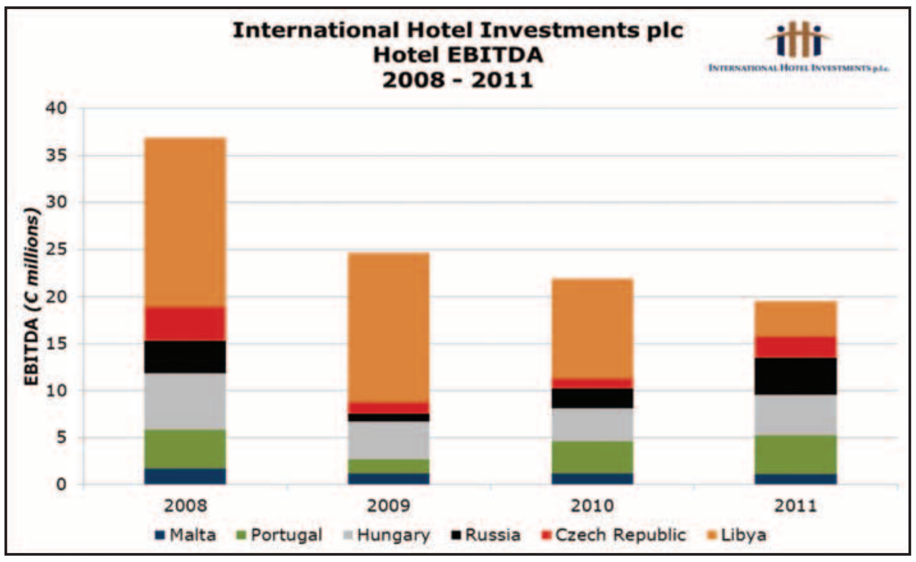

In the annual report Mr Pisani also touches upon other points which should be of interest to shareholders, namely (i) the sale of non-core assets in London and St. Petersburg; (ii) the new equity funding required for further expansion and (iii) the sale of mature hotels to realise the capital gain only if CHI retains the management of the property.

The decision to sell the 12 luxury apartments adjacent to the Corinthia Hotel London and the commercial and office building in St. Petersburg which are referred to as "investment properties" had initially been mentioned last year by the chairman. Mr Pisani however provided an update on these properties and the reasons for the delay in the marketing efforts for the sales to materialise.

The chairman stated that the disposal of the 12 residential properties in London was purposely delayed "as we wanted to ensure that the apartments are fully finished prior to putting them on the market, at which point we should maximise their value". Without giving a firm indication of the valuation attained of these unique properties, Mr Pisani states that "we are sure to realise a very substantial profit equal to at least twice the cost of the land and construction of these apartments". London property is sometimes regarded as a safe haven in these troubled and uncertain economic times and therefore the deteriorating developments across the eurozone could also assist IHI's objective of concluding a sale of this prized asset. Likewise, with respect to the commercial centre in St. Petersburg, IHI is managing to achieve a higher occupancy of the available rentable areas and this should improve the possibility that a sale takes place at the price indicated by global property valuers. In the meantime, the higher rental income from this property will also help the overall performance of IHI from an earnings perspective.

While IHI on the one hand is seeking to sell its non-core assets, it also aims to attract substantial equity funding to make further progress in the ongoing vision for IHI to acquire new properties in key cities across Europe, North America and also China in order to expand the Corinthia brand globally with the ultimate objective to grow the management company especially with third party hotel owners. IHI's plans for a further equity injection had been the subject of a specific company announcement issued on April 23.

Surprisingly, in the annual report, the chairman also announced that the board of directors of IHI is also considering to sell those hotels which have achieved a stabilised level of profitability. This would be a remarkable change in IHI's recent business model. The sale of such hotels together with the disposal of the two non-core assets could release a sizeable amount of funds with the possibility of commencing the long-awaited returns to investors by way of cash dividends – something which continues to remain high on the agenda of the circa 3,000 minority shareholders.

IHI was only set up 12 years ago by the Corinthia Group and in the last few years, the company's developments were affected by significant external factors which impacted them in a negative way including the 2001 twin-tower terrorist attacks and more recently the global economic recession coupled with the Libya developments. Notwithstanding the adversities over the years, IHI continued to strive towards its overall objective and the landmark development in London is testament to the dedication and hard work of the entire management team. The fruit of this hard work should now start showing up in terms of improved operating results, higher property values and a growing presence of the Corinthia brand internationally.

The more meaningful returns from the various hotels and other properties within the IHI Group that should start being generated from 2012 is not only important for the very numerous shareholders who have supported the group over the years but it is equally important for IHI's management team in order to assist them in negotiating a better price for the allotment of new shares to the sovereign funds and other institutions as part of the new equity funding exercise. The successful conclusion of such a deal and the disposal of non-core assets would undoubtedly be a major milestone for the IHI Group and its shareholders.