Stock Market Review

Island Hotels seeking further inroads into catering sector

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Island Hotels Group Holdings plc recently hosted a business lunch for the financial community where CEO Winston J Zahra presented the results for financial year ended October 31, 2011 and provided an operational overview of the various hotels and other businesses forming part of the group. The CEO also provided a short review of the history of the group since Island Hotels is celebrating its 25th anniversary.

Shortly before the meeting got underway, Island Hotels issued an announcement via the Malta Stock Exchange officialising that its 50 per cent-owned subsidiary, Buttigieg Holdings Limited, entered into a franchise agreement to operate the Costa Coffee branded shops in Malta. This had been referred to in the annual report recently distrubted to all shareholders ahead of the annual general meeting. Mr Zahra stated in the annual report that the company is "concluding an international franchise agreement" that will enable it to "convert and yield better overall results from the retail catering side of the Buttigieg Holdings business".

The Buttigieg Holdings subsidiary is one of the most recent ventures of Island Hotels as part of the decision taken to expand its catering business. Island Caterers was always primarily focused on event catering claiming a market leadership position in Malta. Island Hotels proceeded with the acquisition of 50 per cent of Buttigieg Holdings in September 2011 to seek further inroads into the catering sector by gaining exposure to contract and retail catering through this subsidiary.

In turn, Buttigieg Holdings fully owns R.J.C Caterers Limited which is exposed to both retail catering as well as contract catering. The retail catering outlets across Malta mainly trade under the Papillon Caterers brand name with the three catering establishments within the airport terminal regarded as probably the most lucrative outlets for the company in view of the passenger flow through the airport. In the contract catering field, the most prominent contract is the provision of non-patient catering services at Mater Dei hospital as well as a similar contract with MCAST.

The acquisition of 50 per cent of Buttigieg Holdings last year was an interesting one especially from the point of view of the method of financing this acquisition. Rather than the more conventional cash deal, the acquisition was financed via the issuance of 1,070,960 new shares in Island Hotels Group Holdings plc to the three shareholders of Buttigieg Holdings at a price of €1 each (equivalent to both the nominal value and the IPO price level of September 2009). This method of financing an acquisition was replicated almost in exact fashion by Crimsonwing plc last week when it announced details of a share purchase agreement it entered into with the minority shareholders of one of its companies in the Netherlands.

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In the 2011 annual report, Mr Zahra described the Buttigieg Holdings transaction as a "very positive development" for Island Caterers and is "expected to produce significant returns in the years ahead".

In order to grow the business of the new catering venture and improve the operational performance and its contribution to Island Hotels, Mr Zahra and other members of the executive management team of Island Hotel began to assist in the repositioning of Buttigieg Holdings. The franchise agreement is undoubtedly a major milestone in this respect as the three retail outlets within the air terminal and eventually also those across Malta will begin to operate as Costa Coffee shops.

On the strength of the franchise agreement with "one of Europe's strongest and most respect brands in the sector", as described by Mr Zahra in his address to shareholders, Buttigieg Holdings managed to extend the contracts currently in place with Malta International Airport plc until 2022 providing an immediate beneficial impact to Island Hotels Group. In fact, the CEO of Island Hotels argued in the annual report that the longer-term contracts secured revenues "for a much longer period than those on which the company [Buttigieg Holdings] was originally valued prior to the purchase".

Meanwhile, the event catering company, Island Caterers Ltd, also continued to seek ways of maintaining its leadership position in the market. Despite the onset of increased competition from other newly-established ventures, Island Caterers increased its share of the local weddings market and also managed to achieve higher revenues during the past financial year as it was awarded a contract for the catering of the crew of a major film production in Malta. This followed from a highly successful event last year when a major global brand entrusted Island Caterers with the catering of its 4,200 delegates during their four day visit to Malta.

During the recent luncheon, the CEO of Island Hotels also announced two other major developments within the catering business which have the potential of providing an improved contribution in the coming years. Mr Zahra confirmed that Island Caterers was again awarded the exclusive catering contract for the Mediterranean Conference Centre for a further five years while the company also entered into a management agreement for the Monte Kristo Estates, which is another major local event catering venue. Mr Zahra explained that these two locations are among the major venues in Malta for event catering and the latest exclusive agreement "has the potential of improving results for this side of the business substantially".

While Island Hotels has managed to secure some major contracts for the catering side with the possibility of much higher contributions in future years, the overall group performance is still very much reliant on the hotel business, and in particular the vacation ownership sales, in order to try and achieve an overall net profitable position. The financial statements over the past two years showed a loss after taking into consideration the high level of depreciation and finance costs to service its borrowings as a result of the restructuring exercise in 2009 and the decline in vacation ownership sales affected by the difficult economic situation in the UK.

The CEO confirmed during the recent meeting that 2010/11 was another challenging year for vacation ownership sales although some improvements are now being registered as the group is seeking to expand beyond the core market of the UK. Mr Zahra acknowledged that the numbers being generated from outside the UK are still low by comparison. Meanwhile, the CEO also referred to developments in the foreign exchange market indicating that if sterling maintained its current strength against the euro compared to the level as at the end of the last financial year, this will translate into a beneficial uplift to this year's performance since the company entrusted with vacation ownership uses sterling as its accounting reference currency.

Mr Zahra also highlighted the fact that the vacation ownership business holds in excess of 2,300 weeks which could be resold in future years. The stock of unsold weeks has increased in the past two years as the company experienced a larger number of clients who swapped a higher value week from a lower value one following the launch of the new heavenly suites at the Golden Sands resort. The full impact of this would show up once the week is resold at a future date. Based on the average selling price per week, the overall potential from the sale of all weeks represents substantial value which is currently not recorded in the group's financial statements.

The CEO also spoke about the future development of the large tract of land which will be converted into the "Oasis at Golden Sands". The project is still awaiting planning permission but in view of the expected investment necessary for this development as well as other opportunities within the current portfolio of hotels, Island Hotels has joined the growing list of local companies that are seeking to grow their equity base through international sources. While on the one hand, some may view the current eurozone turmoil as a potential deterrent for such equity raising exercises to materialise, other international investors both from South America and the Middle East have hit the headlines across the international media lately as they claim that the eurozone crisis is providing an opportunity for investment across the region.