Stock Market Review

Edward Rizzo

Mr Rizzo is director of Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

IHI strongly placed to weather the storm

Tripoli Hotel helps group to withstand full effects of tourism downturn

The June 2009 interim financial results published by International Hotel Investments plc on August 6 reveal that the total revenue generated by the IHI Group from its six hotels declined by 20 per cent or €12.9 million to €51.4 million.

Immediately after the publication of the results, the company convened a meeting for stockbrokers to explain the underlying reasons for the interim performance and the strategic direction being taken by IHI. Managing director Joe Fenech explained that according to the World Tourism Organisation, the number of tourist arrivals in Europe during the first four months of 2009 dropped by between 9.2 per cent in the Mediterranean and 13.2 per cent in central Europe, whereas the North African region experienced a growth of 6.4 per cent in tourist arrivals despite the international economic recession.

According to Mr Fenech, this reveals the importance of the group's geographical diversification over recent years. While IHI's properties in Malta, Prague, Lisbon and Budapest were affected by the sharp tourism downturn, the hotel in Tripoli continued to record an encouraging performance. This helped the Group not to suffer the full extent of the global downturn in tourism and clearly depicts the importance of the hotel in Libya to the IHI Group. Surprisingly, the managing director highlighted that the decline in revenue was solely due to lower occupancy levels and not as a result of lower room rates. In fact, IHI achieved a slight improvement in the average room rate across its six properties and also managed to gain market share in most destinations. The average room rate increased from €147.53 in the first six months of 2008 to €149.98 in the first half of 2009. This should enable IHI to recover the lower revenue levels quicker when demand re-emerges across its hotel portfolio.

With room rates edging slightly higher and occupancy levels on the decline, IHI and its hotel management subsidiary CHI Ltd focused on a stringent cost-cutting exercise which saw overall costs decline by €7.3 million despite the fact that a number of costs are fixed in this sector of activity. This helped the Group's EBITDA edge 'only' €5.6 million lower to €16.5 million.

After accounting for depreciation, interest expenses and tax payable, IHI registered a loss of €2.8 million compared to a €2.3 million profit in the first half of last year. Coupled with the lower operational performance, an increased depreciation charge (following the launch of the refurbished St Petersburg Hotel) and the recognition of a €1.2 million loss on interest rate swaps hit the Group's interim results. However, the interest rate swap loss is expected to be recovered once these hedging instruments mature.

The leasing of the commercial centre in St Petersburg is expected to contribute around €8 million revenue per annum.

Mr Fenech also delved into the business diversification strategy being adopted by IHI. He explained that the group intends to generate a higher percentage of revenues from rental income and hotel management over the years as opposed to the operational income generated from its current portfolio of six hotels. This strategy entails on the one part moving into real-estate developments not solely focused on hotel business, and on the other undertaking further management contracts of third party-owned hotels.

With respect to rental income, IHI has developed a large retail and office complex with a total rentable area of 11,500 square metres alongside the St Petersburg hotel. Moreover, in their latest two acquisitions in London and Benghazi, there is also a focus on the property development aspect. In London IHI plans to build 12 exclusive residences which will be sold or leased upon completion; in Benghazi, IHI entered into an agreement with LFICO to construct a mixed-use development including 30 residential apartments, commercial offices as well as retail space. Moreover, during the last annual general meeting, IHI's chairman Alfred Pisani had indicated that IHI intends to take a 25 per cent shareholding in the Medina Towers development in Tripoli which was recently awarded to Corinthia's associate company Mediterranean Investments Holding plc.

The rental income currently being generated by IHI is solely from the offices forming part of the 7,000-square-metre Tripoli Business Centre which are fully leased to a number of blue-chip companies contributing around €6.6 million per annum. The leasing of the commercial centre in St Petersburg is expected to contribute around €8 million revenue per annum. In this respect, negotiations are currently underway with potential anchor tenants in the retail section as well as in the office area.

On the other hand, the management of third-party hotels is being conducted by IHI's 70 per cent-owned subsidiary CHI Ltd. During the meeting held on August 6, CHI's CEO Tony Potter explained that although CHI will be increasing its management agreements from the new IHI-owned properties in London and Benghazi in the coming years, the focus remains mainly on third-party management contracts as this subsidiary seeks to fully exploit the benefits of being integrated with the reservation system of Wyndham.

Over the past 12 months, various agreements were signed with a number of hotels and resorts in Sharm El Sheikh, Liverpool, Abu Dhabi, Bucharest, Budapest and Morocco. Since these properties are all new developments, the real benefit to CHI, and in turn IHI, will only begin to show in three to four years' time.

Meanwhile, CHI is also focusing on seeking agreements with hotels already in operation and Mr Potter announced the company is currently negotiating a total of 45 agreements. While these are not all expected to fully materialise, the CEO of the management company expects a number to be successfully concluded. This will push CHI's operational performance to a higher level.

CHI currently has agreements to manage a total of 18 hotels (including the confirmations concluded in recent months) and the aim is to increase this to 65 properties by 2015. Following the introduction of Wyndham as a 30 per cent shareholder in CHI, the hotel management company is also responsible for the Wyndham and Ramada Plaza brands in Europe and Africa.

While the main area of growth lies in the use of these brands, the focus is also on increasing the awareness of the Corinthia brand as the foremost mark for quality excellence in CHI's portfolio. The opening of the London hotel in October 2010 is expected to strongly promote the Corinthia brand and the presence of Corinthia in some of the major destinations is one of the primary reasons behind IHI seeking further property acquisitions in Paris, Rome, Milan, Madrid and possibly also in New York.

IHI's half-year report refers to the fact that a number of properties are likely to have their value reduced at the year-end due to the weak operating performance this year. However, the financial statements show that IHI is in a strong financial position with total equity of €621 million compared to net borrowings of €216.4 million.

This healthy ratio enables the group to weather the current storm and places it in a strong position to take full advantage of the expected turnaround in tourism over the coming years. Moreover, as part of IHI's growth strategy, the downturn also presents investment opportunities which could prove to be very valuable once business confidence returns. Once the recovery takes place, IHI is also expected to commence a regular cash dividend to shareholders. This may prove to be the catalyst for a long-anticipated upturn in IHI's share price.

> **IHI is in a strong financial position with total equity of €621 million compared to net borrowings of €216.4 million.**