EDISON

Action Hotels

First day of dealings

Louder than words

Travel & leisure

Action Hotels is the first Middle East-based IPO available to AIM investors in the current upturn. Founded and grounded in the region, it has created an effective platform for growth. This IPO kick-starts the next phase, powered to increase room inventory by 150% in three years with resulting enhancements to results. At a 9% discount to NAV, with a 1.5% yield for 2013 and 3.4% for 2014, the shares are attractively priced.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	EPS* (c)	EV/EBITDA (x)	NAV ($m)
12/10	21.0	3.1	(4.7)	(4.7)	41.0	16.7
12/11	25.2	6.0	(3.3)	(3.2)	21.2	23.6
12/12	28.2	8.8	(0.3)	(0.5)	14.4	41.4

Note: *Normalised, excl. exceptions. Excl. revaluations (US$54m cumulative to June 2013).

Investment case based on roll-out

Action Hotels (Action) is a hotel developer, owner and asset manager with a clear roll-out strategy, primarily in the under-supplied Middle East economy and midscale market, as well as the stable Australian market. It has a strong openings pipeline, and plans to grow its room stock by 150% by 2016.

Transparent business model

As developer and owner, Action enjoys strong relationships with world-class brands Premier Inn, ibis, and Holiday Inn, which operate under management agreements. The operators recognise the potential for branded economy and midscale hotels, but high barriers to entry exist in local markets. The legal structure maintains local ownership requirements, while management's influence, reputation and contacts enable it to identify opportunities and execute its development plans.

Dynamic market positioning

The Middle East is an attractive hotel market. The GCC grew GDP by a buoyant 5% in 2012. Tourism spend is forecast to grow 6% for 2013-17, significantly above developed markets. Yet at 22% of branded hotel stock, Middle Eastern economy and midscale capacity is significantly under-supplied. Action's pipeline puts it on course for a c 25% share of GCC-branded midscale and budget hotel units.

Sensitivities: Well represented in the region

As well as operational and development risks, performance could be affected by country risks, although there are good connections with decision makers. Execution will require additional mid-management, which we believe is being proportionately planned. It is also dependent on raising some $75m of new debt, which should be straightforward on continuation of the current c 50% loan-to-value debt structure.

NAV discount attractive given growth prospects

While positive P/E remains in the future, EV/EBITDA has reduced from 41x in 2010 to 13x (annualised) at H113. Today's IPO issue price represents a 9% discount to pro forma June 2013 NAV, which is attractive given the strong growth prospects.

23 December 2013

Price	**64p**
Market cap	**£95m**
	US$1.64/£
Net debt (£m) June 2013* *Pro forma, including placing proceeds.	32.6
Shares in issue	147.6m
Free float	33%
Code	AHCG
Primary exchange	AIM
Secondary exchange	N/A

Business description

Action Hotels is an owner, developer and asset manager of branded three- and four-star economy and midscale hotels in the Middle East and Australia. The company began trading on AIM on 23 December raising £30.5m gross.

Next events

2013 final results	April 2014 (estimated)

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Action Hotels is a research client of Edison Investment Research Limited

A strategy to succeed

Clear business model

Action Hotels has a clear and simple strategy focused on economy and midscale hotels in the Middle East and Australia in leading branded formats. As a developer and owner of hotels, its main brand relationships are with world-class brand operators – Whitbread's Premier Inn, Accor's ibis Hotels and IHG's Holiday Inn, which operate them under management agreements. The company has six completed hotels, all now operational. The five trading in H1 show an impressive mix of revpar (revenue per available room) growth, absolute revpar levels and occupancy.

Exhibit 1: Hotel performance, June 2013 ytd

Property	Rooms	Occupancy	Revpar $	Revpar growth
Ibis Salmiya, Kuwait	175	86%	123	9%
Ibis Sharq, Kuwait	160	83%	95	31%
Ibis Amman, Jordan	158	85%	75	3%
Ibis Muscat, Oman	171	82%	87	13%
Ibis Glen Waverley, Melbourne	155	66%	154	4%
Total/weighted (by room) average	**819**	**81%**		**12.0%**

Source: Action Hotels

Key to the strategy is the fact that the group structure ensures operating companies are majority controlled by nationals, as required for property ownership in the Gulf Co-operation Council (GCC) region. This is an effective barrier to entry to potential competitors, including the brand owners themselves. The hotels are a mix of owned and leased properties, all of which are held and controlled within the group. In addition, the influence, reputation and contacts of management enable the company to execute the necessary stages in property and leisure development.

Attractive market

The Middle East is an attractive market for hotel investment. GCC states grew 2012 GDP in the range 2.8-6.2%, averaging 5%, against 1.7% for the G7 (source: IMF). Tourism spend in the GCC is forecast to grow at an average of 6% for 2013-17, against 2.8% for Europe and 3.4% for North America (source: WTCC). Moreover, regional governments are increasingly supporting tourism as their economies diversify away from oil production.

As with many immature hotel markets, upscale brands were the first entrants in those regions. As a result, for the economy and midscale market, only 22% of current room capacity is branded against 48% in Europe and 64% in the US (source: STRG).

Action is a prominent and trusted local partner for major branded hotel operators. Whitbread, in its July investor day for Premier Inn, stated that, including pipeline, it plans eight of its own Premier Inns in the GCC region, expects 12 from ibis and five from Holiday Inn Express. Of those, we expect Action to own three Premier Inns and six ibis hotels, which, when also taking account of local brands, suggests the company is on course for a c 25% share of expected branded midscale and budget hotel units in the GCC.

Australia, although not expanding economically at the same rate as the GCC, is a relatively mature economy, where the company owns one high revpar site in Melbourne and plans a second in Brisbane.

Pipeline ready to roll

We show management's room roll-out plan in Exhibit 2 below, resulting in 2,516 rooms projected by 2016, a 150% increase on the current 1,004. The IPO proceeds, together with new debt and cash flow, are to fund this development phase. The plan involves a total of eight hotel units. Two are

currently under construction and a further six, as well as one room extension project, are at various stages of development. We have discussed the pipeline with management and consider that most are at a relatively advanced stage, the most advanced being in a tender process for fit-out, the least still going through approval for tourism, for example. However, in each case where a freehold, lease or option to lease has not yet been signed, there is a letter of intent from the operator.

Exhibit 2: Pipeline

Hotel	Country	City	Rooms		Opening	Tenure
Under construction						
Premier Inn	UAE	Sharjah	166		2014	Freehold
ibis Seef	Bahrain	Manama	304		2014	Freehold
Subtotal			**470**			
Construction yet to start						
ibis Salmiya (expansion)	Kuwait	Kuwait City	10		2014	Leased
Premier Inn	Bahrain	Manama	119		2014	Leased*
Premier Inn Jeddah Industrial	Saudi Arabia	Jeddah	90		2015	Leased*
ibis Brisbane	Australia	Brisbane	368	**	2015	Freehold
Premier Inn Dubai Health Care City	UAE	Dubai	215		2015	Leased*
ibis Sohar	Oman	Sohar	128		2016	Freehold
Staybridge Suites Abu-Dhabi	UAE	Abu-Dhabi	112		2016	Leased*
Total			**1,512**			

Source: Action Hotels. Note: *Option to lease. **Planning consent received for 289 rooms (Novotel); application submitted to increase to 368 rooms.

Management – an appropriate mix

Management shows an appropriate mix of local identity and international professionalism.

Sheikh Mubarak Al Abdullah Al-Mubarak Al-Sabah, non-executive chairman, is also vice chairman of AGH, the majority shareholder, which is a Kuwaiti private holding company and has invested $98m in the company since inception. He is a Sandhurst graduate and has an MPhil in international relations from Cambridge and a BA (Hons) in political science with economics from the University of Buckingham. He was named a Young Global Leader in 2009 by the World Economic Forum, is a member of the Young Presidents Organisation in the Middle East and of The Royal Institute of International Affairs, and is on the board of various large regional companies.

Alain Debare, CEO, joined Action Hotels in February 2008, soon after its inception as a separate entity from AGH. He previously held positions with Mandarin Oriental and Hilton Hotels Corporation, where, after joining in 1996, he worked his way through hotel operations to reach general management. He holds a BA in hotel management from Institut Paul Bocuse – IGL Lyon in France and a certification in hospitality investments and asset management from Cornell University.

Alaister Murray, FD, is a chartered accountant who spent 10 years with PWC in Northern Ireland and Dubai in its business assurance and corporate finance departments. For the past 16 years, he has worked initially with Emirates National Oil Company and from 2002 to 2012 as CFO of Jumeirah Hotel Group. He has a total of 21 years' experience in the Middle East.

Sensitivities

Execution of the roll-out is the primary and obvious risk to the target of 1,512 additional rooms by 2016. However, as well as the usual industry operational and development risks, performance could potentially be affected by country risk, including economic variations, and legal, political and social issues in the region. As a counter to this, the company is well connected with decision makers in the region, which is characterised by firm government, break-even occupancy is low at 33%, and with two hotels under construction, there is little development risk for 2014. The ownership structure is designed to ensure that the properties are held and controlled within the group.

Realisation of the pipeline will require additional mid-management, which we believe from our discussions is appropriately planned. It is also dependent on raising new debt of an estimated c $75m. This is expected to be straightforward; in terms of raising debt finance against each project, the current loan-to-value of c 50% is not expected to change.

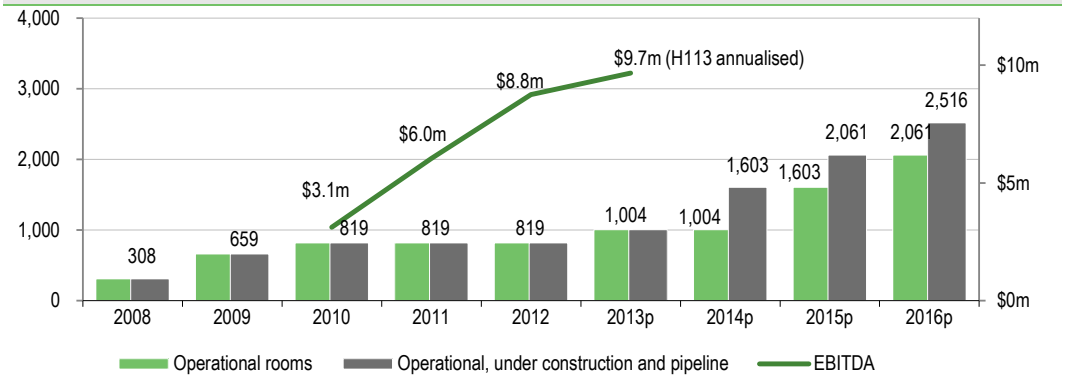
Financials – buoyant results, ready for a step change

In the three years to 2012, EBITDA grew at a CAGR of 68% and operating profit turned round from a loss of $4.5m to a positive $4.7m.

In Exhibit 3, we highlight the expected room pipeline and track the growth in EBITDA to date. It is notable that for 2010-12 the number of rooms remained constant, representing the five operational hotels, all of which opened between 2008 and 2010, as the company engaged in developing three greenfield projects, all due to open in 2014 (see Exhibit 2). The strong increases in EBITDA in that period can therefore be seen as a lagged business-building phase in the development of the existing hotel estate, now starting to flatten slightly. In the half-year to June 2013, EBITDA grew by 17% to $4.8m, while pre-tax loss increased from $0.3m to $1.8m reflecting an Australian dollar exchange loss. Gross margin was strong at 76% before G&A costs and rent.

Cash flow for the last three years has been positive, but has been used to fund hotel investment (including projects now under construction) and substantial interest payments. Free cash flow for 2012 was an outflow of £2.1m.

Exhibit 3: Actual and projected room pipeline, EBITDA growth to date



Source: Action Hotels. Note: p = planned.

Management expects the planned tripling of the room stock in the next three years to generate a step change in earnings and profits. We believe the company possesses the structure, management skills and relationships to turn this into reality. It would be reasonable to expect a similar lagged effect to that seen in 2010-12.

Management expects to pay a dividend of 0.96p (1.5%) per share for 2013, and to inaugurate a progressive dividend policy from 2014, with an initial 2.17p (3.4%).

The majority shareholder, AGH (64.7%), has committed to a two-year lock-in period.

Valuation

Action Hotels is still developing the earnings that will generate conventional P/E ratios. However, EV/EBITDA based on the post-IPO structure has reduced from 41x in 2010 to 14x in 2012, and 13x annualised from H113.

Property revaluations from inception to June 2013 have amounted to $54m, an average uplift on development of 33% on the current portfolio. On the pro forma balance sheet at June 2013, adjusted for IPO proceeds and related matters, NAV was $170.2m (£103.8m) equivalent to 70.3p per share. Against that, the placing price of 64p represents a 9% discount.

Exhibit 4: Financial summary

Year-end 31 December	US$m	2010	2011	2012
		IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue		21.0	25.2	28.2
Cost of Sales		(5.8)	(6.7)	(7.0)
Gross Profit		15.2	18.4	21.2
EBITDA		3.1	6.0	8.8
Operating Profit (before amort. and except.)		0.5	2.7	5.5
Intangible Amortisation		(5.0)	(0.6)	(0.5)
Exceptionals				
Other		(0.0)	0.0	(0.2)
Operating Profit		(4.5)	2.2	4.7
Net Interest		(5.2)	(6.0)	(5.8)
Profit Before Tax (norm)		(4.7)	(3.3)	(0.3)
Profit Before Tax (FRS 3)		(9.7)	(3.8)	(1.1)
Tax		0.0	0.0	0.0
Profit After Tax (norm)		(4.7)	(3.3)	(0.3)
Profit After Tax (FRS 3)		(9.7)	(3.8)	(1.0)
Average Number of Shares Outstanding (m)		100.0	100.0	100.0
EPS - normalised (c)		(4.7)	(3.2)	(0.5)
EPS - normalised and fully diluted (c)		(4.7)	(3.2)	(0.5)
EPS - (IFRS) (c)		(9.7)	(3.8)	(1.0)
Dividend per share (p)		0.0	0.0	0.0
Gross Margin (%)		72.2	73.2	75.1
EBITDA Margin (%)		14.8	24.0	31.0
Operating Margin (before GW and except.) (%)		2.4	10.8	19.4
BALANCE SHEET				
Fixed Assets		176.9	200.5	223.9
Intangible Assets		14.9	14.5	13.8
Tangible Assets		162.0	186.1	210.2
Investments		0.0	0.0	0.0
Current Assets		12.3	12.9	23.1
Stocks		0.1	0.1	0.1
Debtors		2.1	2.3	4.4
Cash*		1.2	1.3	1.4
Other - due from related parties		8.8	9.1	17.2
Current Liabilities		(158.3)	(171.1)	(184.6)
Creditors		(12.7)	(14.0)	(14.3)
Short term borrowings		(145.5)	(157.2)	(170.3)
Long Term Liabilities		(14.2)	(18.7)	(21.0)
Long term borrowings		(10.1)	(11.0)	(11.3)
Other long term liabilities		(4.1)	(7.7)	(9.7)
Net Assets		16.7	23.6	41.4
CASH FLOW				
Operating Cash Flow		4.7	7.2	9.0
Net Interest		(5.3)	(5.7)	(5.8)
Tax		0.0	0.0	0.0
Capex		(13.0)	(10.8)	(5.3)
Acquisitions/disposals		0.0	0.0	0.0
Financing		(1.9)	(2.4)	(11.4)
Dividends		0.0	0.0	0.0
Net Cash Flow		(15.6)	(11.6)	(13.5)
Opening net debt/(cash)*		138.9	154.4	166.8
HP finance leases initiated		0.0	0.0	0.0
Other		0.0	(0.7)	0.1
Closing net debt/(cash)*		154.4	166.8	180.2

Source: Action Hotels. Note: *Excludes restricted cash ($0.6m at 31 December 2012).

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