



## Legacy Hotels Real Estate Investment Trust (LGY.UN:TSX)

### THE COMPANY

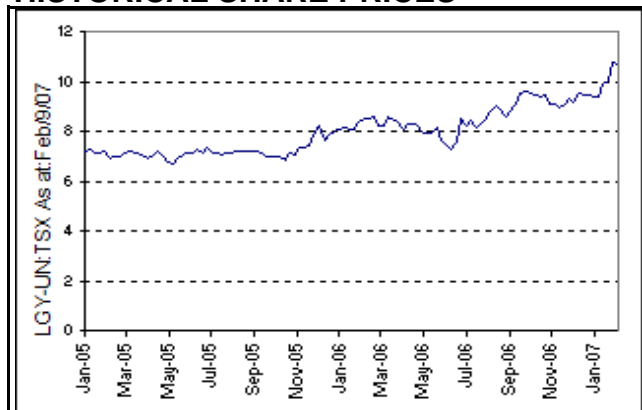
Legacy Hotels REIT owns 24 hotels with 10,000 guestrooms in both Canada and the United States. The REIT owns several of Canada's landmark hotels, including the Fairmont Chateau Frontenac and Toronto's Fairmont Royal York. In addition to its luxury properties, Legacy's portfolio includes 11 Delta hotels and the Sheraton Eua Claire in Calgary, Alberta. Fairmont Hotels, the Trust's property manager, has roughly a 20% economic interest in the REIT.

### FINANCIAL DATA

	2002	2003	2004
FFO* (\$)	0.86	0.17	0.53
Price to FFO* (times)	8.14	41.18	13.20
Distribution (\$)	0.19	0.24	0.32
Distribution Yield (%)	2.64	3.43	4.57
Net Asset Value** (NAV) (\$)	8.50	8.25	9.00
Price to NAV (times)	0.82	0.85	0.77

\* Funds From Operations, \*\* Estimated NAV at year end

### HISTORICAL SHARE PRICES



### WHY ABC FUNDS BOUGHT LEGACY HOTELS

We believe Legacy Hotels REIT is an example of the market failing to see the forest for the trees. To be sure, Legacy's recent operating performance has significantly lagged its Canadian peer group. The Trust's core business - hotel ownership - has suffered in the wake of the 9/11 terrorist attacks, SARS, an appreciating Canadian currency, and even the NHL lock-out. We also acknowledge that Legacy's uninspiring results are not entirely due to factors outside the REIT's control. As other REITs have recovered from these events, Legacy's upscale properties have struggled to find their own identity and position in an increasingly crowded luxury hotel market. The Trust's gross margins are still below pre-2001 levels, with RevPAR and FFO growth muted. Clearly, investors have not been impressed with the performance of the Trust: Legacy's units are down 40% from its \$10/unit 1997 initial public offering.

Despite the Trust's near-term challenges, we believe the units are fundamentally undervalued at current prices. Legacy's most recent balance sheet lists the hotel portfolio's cost at \$1,763 billion (giving the Trust a book value of around \$7 per share). Recent market data suggests that asset values in many of Legacy's markets have appreciated significantly since its 1997 offering. According to Colliers International, a respected real estate services firm, hotel assets in major urban markets such as Toronto, Vancouver, and Edmonton have appreciated as much as 20% since 1997. Using very conservative assumptions, we derive a net asset value (NAV) of at least \$8.50 per unit on a "per key" basis. A cap rate approach using a normalized income stream supports this valuation.

While we believe that the Trust's current hotel properties are worth at minimum \$8.50 per unit, we see an opportunity to unlock even greater value. During the hotel industry's extended downturn, which in hindsight commenced after the 9/11 terrorist attacks, Legacy purchased three hotels and raised over \$400 million in debt and equity. Unfortunately, business has been below plan since these hotels were acquired. Since 2001, interest costs have increased by 50% while operating income has remained virtually unchanged. We believe the time has come for Legacy to focus in on its current assets and examine strategic alternatives that will surface their hidden value.

One potential initiative, which has been very popular south of the border, is condo conversions. Many of Legacy's hotels, such as the Toronto Royal York and Hotel Vancouver, are located in prime residential areas. Not only could Legacy take advantage of a strong condo market but the REIT could also eliminate some occupancy and cost issues within their major landmark hotel system. In addition to turning current hotels into condominiums, Legacy has excess lands adjacent to many of its hotels that could be developed with partners or sold outright. For example, excess land next to the Fairmont Chateau Laurier, situated next to the Rideau Canal, would be an ideal location for a condominium project. Lastly, the REIT's "air rights" allow it to add residential and office space to existing hotels. We believe that development projects and condo conversions could add between \$0.50 to \$1.50 per unit in incremental value, leaving us with a total NAV between \$9.00 and \$9.50 per unit.

## UPDATES

On October 24th, Legacy Hotels reported its operating results for the first nine months of 2005. Considering that travel to Canada from south of the border hit a 26 year low during the third quarter, the REIT's results were more than respectable. Legacy's RevPar (revenue per available room) grew 4.4% when compared to the third quarter of 2004. The portfolio's strongest results continue to be posted by Delta branded hotels and the REIT's two U.S. Fairmont branded hotels. City centre locations in Montreal, Vancouver, and Toronto continue to be laggards when compared to the growth demonstrated by the Trust's Canadian peers. Taking a step back, we would like to note that Legacy's revenue and EBITDA per room owned were the highest and third highest, respectively, since the REIT's initial public offering. While we do not expect a quick recovery with respect to the Trust's core operations, we are encouraged with the various initiatives they have outlined that will narrow the gap between revenue and earnings.

ABC Funds  
October 28, 2005

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On Nov. 7th, U.S. regulatory filings revealed that billionaire investor Carl Icahn had accumulated a 9.3% stake in Fairmont Hotels & Resorts Inc. In the documents filed with regulators, Mr. Icahn cited Fairmont's undervalued share price for the reason behind his investment. Elaborating further, Mr. Icahn suggested that Fairmont executives pursue strategic alternatives such as asset sales and share buybacks to unlock shareholder value. Given the demand for hotel assets from private equity groups, supply constraints, prohibitive construction costs, and historically low financing costs, we agree that many hotel assets are not properly priced in the public markets. As evidence, another ABC Funds holding, La Quinta Properties, agreed to be purchased by The Blackstone Group two days after Mr. Icahn's Fairmont stake was made public.

We believe that, on balance, this news is positive for unit holders of Legacy Hotels REIT. While it is too early to speculate on Mr. Icahn's endgame, one possible option may be to put Fairmont "in play". Any purchaser of Fairmont would have to decide what to do with the Company's 24% interest in Legacy. Considering that Legacy is immaterial in every respect to Fairmont's bottom line, the most obvious course of action would be to carve out Legacy and deliver it to a real estate player who could unlock its underlying value. Fairmont, remaining Legacy's property manager, could use the sale proceeds (which could be around \$220 million) to reinvigorate its focus on its core business of hotel and resort management.

Interestingly, Legacy would command a higher valuation outside of a REIT structure. A private entity or corporation could unlock Legacy's hidden assets to the fullest. Legacy has identified numerous value creating opportunities such as condo conversions, joint venture construction projects, and land sales. However, Legacy's Declaration of Trust, which explicitly states that its reason for being is to pay out a stream of income to unit holders, restricts its ability to employ risk capital. Under a corporate structure, significant risk capital could be deployed while simultaneously reinvesting the \$33,000,000 that is paid out to unit holders every year. Given that Legacy has nearly \$2.00 per unit in land (adjusted to market value), and an estimated \$0.50 - \$1.50 in incremental development opportunities, Legacy's net asset value (NAV) could be more than \$10.00 per unit if its assets were placed under a different corporate structure.

Of course, Fairmont may ultimately decide to maintain the status quo. Fairmont and Legacy have stressed that their relationship is strategically important. Whether or not any immediate action results from Mr. Icahn's interest in Fairmont, Legacy's compelling under-valuation does not change.

ABC Funds  
November 25, 2005

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With Kingdom Hotels rescuing Fairmont from the clutches of Carl Icahn, the fate of Legacy Hotels is now open to speculation. While Legacy was not mentioned in Fairmont's initial press release, we believe that Legacy will be the focus of Raffles/Fairmont executives as the deal comes to a close in the second quarter of 2006. The absence of Legacy from the deal has led some to believe that the Trust's fate is on the backburner. However, we point to the fact that Legacy owns 40% of Fairmont branded hotels in Canada and 24% of Fairmont branded hotels around the world. Clearly, Legacy plays an important role in the future of the Fairmont brand.

We see three clear alternatives in front of the Fairmont/Raffles organization: purchase Legacy outright and fold it into Fairmont/Raffles, facilitate the sale of the Trust to a third party, or sell its 24% interest to the public market. While status quo was once a viable alternative, Fairmont's current relationship with Legacy does not make sense within the context of an organization with over 120 hotels in 24 countries. From a financial perspective, Legacy was already non-essential to Fairmont; now, as part of a much larger entity, its contribution to the bottom line is even less significant. The old Fairmont management was content to let its real estate portfolio, which included Legacy, languish despite record real estate values (which opened up

## UPDATES (cont'd)

the door to Carl Icahn). We suspect that the new Fairmont/Raffles team will critically analyze the \$180,000,000 that is tied up in this underperforming investment and eventually realize the true value of Legacy's portfolio for the benefit of all investors.

ABC Funds  
February 3, 2006

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When we purchased Legacy Hotels late in 2005 we envisioned holding the security for many years as the REIT undertook initiatives to bridge the gap between its market price and the fair value of its hotel properties. With Legacy units up approximately 50% since our purchase, we felt it important to re-examine our position in light of the current environment.

The real estate landscape has changed dramatically over the last year. Record investment activity in the hotel industry (\$2.6 billion last year in Canada alone) has pushed capitalization rates to increasingly low levels. For example, the cap rate on the recent sale of seven Fairmont hotels to Oxford was below 5.00%. Many hotel transactions south of the border have been consummated with rates between 5.50% and 6.50%. Legacy's unit price has continued to rise as lower and lower transaction multiples are reported.

Now trading close to \$11.00 and with an implied cap rate between 6% - 6.5%, we believe that Legacy's units appropriately reflect the fundamental value of the REIT's properties. As outlined in our previous updates, we have always felt that Legacy would be an attractive takeover target, and we recognize that in light of the recent frenzied demand for hotel properties the REIT could be taken out at a higher level. Amidst such euphoria, we see signs on the horizon that lead us to take a more cautious stance. Rock bottom cap rates make it virtually impossible for publicly traded REITs such as Legacy to execute accretive deals. With the cost of capital above cap rates, higher debt levels and aggressive assumptions about future performance are required to justify deals. More broadly, we question if such low cap rates (in some cases below T-bills) are appropriate for such a notoriously cyclical industry that demands large capital expenditure to grow at a rate higher than inflation.

With so many parties armed with cheap money, investor speculation could push Legacy's units higher. However, we are currently finding more compelling opportunities on a risk/reward basis. Accordingly, we have liquidated our entire position in Legacy. We take comfort from the fact that many long-standing industry participants such as Sam Zell and Lou Maroun have decided to take advantage of the frenzied activity to take their chips off the table as well.

ABC Funds  
February 9, 2007