Published Date:	16 Jul 2023	Publication:	The Hindu Business Line [Hyderabad]
Journalist:	Kumar Shankar Roy	Page No:	1
Circulation:	27,127		

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Check 'n' book.

Here are 4 key factors investors eyeing hotel stocks need to track

BIG STORY P2

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At home, with hotel stocks

CHECK 'N' BOOK. Here are 4 key factors investors need to monitor if they want to tap the opportunity in the hotel industry

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After hitting the nadir in FY21, courtesy the Covid pandemic, the hotel industry in India has rebounded like the mythical Phoenix bird that comes to life by rising from the ashes. While initially hotels were seen benefiting from 'temporary' revenge travel, pretty soon it became clear that India's hotel industry is on a strong wicket, thanks to robust turnaround in demand after the pandemic. The sentiment in the industry is positive as witnessed by the results in the past few quarters. In fact, FY 2022-2023 was a record year for
1 many listed hotel companies.

The industry is witnessing renewed growth and is understood to be in an upcycle, which is expected to last for the next few years as demand outstrips supply. Hotel stocks, enthused by robust performance and potential for sustained growth, have moved to a different orbit. The 3-year compounded annual growth rate (CAGR) for prominent hotel stocks such as Indian Hotels Co. (71 per cent), EIH (49 per cent), Chalet (51 per cent), Lemon Tree (56 per cent) and Royal Orchid (76 per cent is 2-3 times of bluechip Sensex's 21.7 per cent run in the same period. Investors, like customers, are eager to check-in. Here are 4 key factors to monitor before you enter hotel stocks.

HOTEL POSITIONING

Hotels are positioned to cater to needs such as luxury, premium, budget and value travellers. While some listed hotel companies cater to a wide range, others are extremely focussed. For instance, Indian Hotels Co. Ltd (IHCL) features hotels under the iconic Taj brand, upscale offering Vivanta, premium properties under SeleQtions and the budget range under Ginger, thus offering rooms across price points. EIH Ltd has hotel brands such as Oberoi (luxury), Trident (5-star) and Maidens (heritage).

In comparison, Lemon Tree is focussed on mid-priced hotels through various brands such as Aurika, Lemon Tree Premier, Lemon Tree Hotels, Red Fox, Keys (Prima, Select and Lite). Royal Orchid operates 5-star, 4-star (Royal Orchid Central & Regenta Suites), resorts and budget hotels (Royal Place & Regenta Inn), focussing on business and leisure travellers. Chalet Hotels operates high-end hotels and is also a hotel-led, mixed-use developer.

As per HVS Anarock data for May-2023, the India average daily rate (ADR) was ₹6,700-6,900, with occupancy of 61-63 per cent. The way the hotel business is positioned has a bearing on room rates, although there will be monthly swings. But companies with luxury rooms/properties fetch higher room rates, backed by the promise of better experience.

The room rate is ₹18,200 for EIH (including managed hotels), around ₹11,220 for IHCL (all domestic hotels including Ginger), ₹11,300 for Chalet, ₹5,600 for Lemon Tree, and ₹5400 for Royal Orchid, etc. Given the high demand for rooms, monthly/quarterly occupancy rates ranged at 68-78 per cent for these hotel companies, much ahead of the national average. While globally the entry of travel/hotel aggregators has intensified the competitive landscape, this risk has so far not played out in India due to much bigger market opportunity and low penetration (53K hotels in India vs 1.66 lakh in the US).

However, higher room rates don't always translate to higher EBITDA margins. It is likely that higher room rates will entail higher costs too. For example, in FY23, the consolidated adjusted EBITDA margins for Chalet (40.1 per cent) and Lemon Tree (51 per cent) are higher than for IHCL (31.1 per cent) and EIH (29.7 per cent), which are comparable to Royal Orchid (31.1 per cent) despite the latter's room rates being less than half of the hotel giants'.

Another factor that could probably work in favour of India-focussed hotel chains such as Lemon Tree is the absence of relative drag from international properties. For instance, average room rates ($274 vs $236) and occupancy (58 per cent vs 55 per cent) of international hotels of IHCL have inched up in Q4 of FY23 vs Q4 of FY20 (pre-Covid period). Hence, the portfolio mix of domestic and international hotels is a monitorable.

EXPANSION PLANS

Prominent hotel stocks in India, among themselves, offer investors revenue and profit potential from 42,000+ rooms. For instance, IHCL gives exposure to 21,600+ rooms. Lemon Tree (8,300+) and Royal Orchid (5,400+) are next in pecking order in number of rooms. EIH, though being the second-largest in terms of m-cap, has a room portfolio of about 4,300 (including 11 per cent abroad). Chalet is at 2,600+. There are also smaller listed companies in this space such as HLV, Sayaji Hotels, Kamat Hotels, Advani Hotels, Sinclairs Hotels, Asian Hotels (N) and Asian Hotels (E).

Existing rooms offer only limited leverage to boost revenues at a time when tourism in India seems to be at inflection point. While F&B revenue (usually 40-50 per cent of room nights sales), better daily room rates (with arrival of international tourists), higher occupancy and cost reductions can be used as levers, expansion holds the key to future earnings growth. Hoteliers have already undertaken various cost-reducing initiatives during the pandemic, such as multitasking workforce, reducing staff/room ratio, and lowering overhead expenses.

Substantial additions to rooms and properties over the next few years and sustained operating margin improvements can pay rich dividends, amid immediate triggers — such as Government's intent to leverage the G20 Summit to boost inbound tourism, the men's cricket ODI World Cup in October 2023 and the recovering international tourist footfalls, post-Covid. Given the upcycle in the hotel industry, players that expand operations simultaneously hold an edge. IHCL is set to add about 9,900 rooms (45 per cent of existing room count) by FY27. EIH plans to add about 750 rooms (17 per cent) by FY27, but that supply is poised to start from FY25. Lemon Tree plans to add 2,540 rooms (approximately 30 per cent) by FY27, while Chalet aims to add 1,100 rooms (43 per cent) by FY26. Some players such as Royal Orchid disclose pipelines for short term, for instance, 1,100+ rooms by 2023.

The route adopted for expansion is also crucial. There are typically 4 ways to add hotels/rooms: Owned, Leased, JV and Managed/Franchise. These days, management contracts or asset-light strategy are the preferred route, given 5 main advantages. One, they facilitate expansion plans and ramping up presence. Two, they create brand visibility at a faster rate. Three, there is no upfront requirement of capex. Four, minimal maintenance capex is required. Fifth, break-even at operating profit level in 12-15 months.

But note, occupancy rates and room rates may be lower in case of managed hotels since newer properties come up in tier-2 & 3 locations. Players such as Royal Orchid have over 70 per cent in management/franchise contracted properties. Lemon Tree has 40 per cent rooms via this route. IHCL is aiming to add 70+ per cent fresh room supply through management contracts.

MONETISATION PLANS

For hotel companies, rooms are the main cash cows. Asset sales do sometimes fetch money. For instance, Kamat Hotels early this year said it has signed an agreement to sell the Mumbai-based VITS unit for up to ₹125 crore. Lemon Tree has a plan to dilute ownership in the owned portfolio (while retaining majority shareholding) through in a bid to monetise/unlock cash.

Bigger players have also entered into hotel/hospitality allied areas. If these become large enough, there is scope for value unlocking and monetisation. For example, IHCL's budget hotel chain Ginger has become a ₹300-crore annual business with 39 per cent margins (before fees).

In air catering, IHCL operates TajSATS (₹640 crore sales), while EIH has a flight catering and airport lounges business. EIH also has exposure to Mercury Car Rentals, a JV with Avis. F&B outlets such as food delivery 'Qmin' (IHCL) and casual dining 'Cou Cou' (EIH), once scaled up, hold promise.

The fourth factor for investors to track is valuations (elaborated in box below).

FY23 scorecard for top hotel stocks

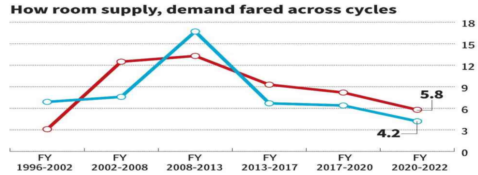
Above data is on consolidated basis Source: Capitaline, Bloomberg

Key stats for hotel sector

	May 2023	% change over May 2022 (Post-Covid)	% change over May 2019 (Pre-Covid)
Average daily rate (₹)	6,700-6,900	14-16	24-26
RevPAR (₹)	4,087-4,347	12-14	23-25

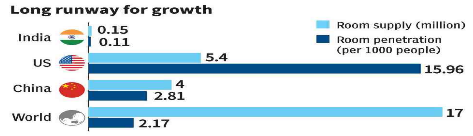
Source: HVS Anarock June-2023 report

How room supply, demand fared across cycles



Source: HVS, Hotelivate, HSIE Research

Long runway for growth



Source: US Census Bureau, STR, HSIE Research

How top hotel stocks have moved

Name	CMP (₹)	1-year change %	3-years change % (CAGR)
Indian Hotels Co	389.55	59	71
EIH	212	62	49
Chalet Hotels	452	43	51
Lemon Tree Hotels	92.3	44	56
Royal Orchid Hotels	322	123	76

Source: BSE, Value Research