

refreshingly different



LEMON TREE HOTELS LIMITED

RISK MANAGEMENT POLICY

INTRODUCTION

The Ministry of Corporate Affairs, Government of India had accepted the concept of Risk Management and its relevance to smooth functioning of the Corporate sector in India and had therefore introduced a specific provision on Risk Management under paragraph II (C) of Corporate Governance Voluntary Guidelines, 2009.

Taking the same further, the Companies Act, 2013 now requires that:

- The Board of Directors report must include a statement indicating development and implementation of a risk management policy for the company including identification of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company (Section 134);
- The Audit Committee shall act in accordance with the terms of reference specified in writing by the Board, which shall, inter-alia, include evaluation of risk management systems (Section 177);
- Independent Directors should satisfy themselves that systems of risk management are robust and defensible (Schedule IV);
- It has therefore become mandatory for the companies to prepare a comprehensive framework of risk management for assessment of risks and determine the responses to these risks, that the Board feels, may threaten the existence of the company.

By "Risk Management" we at Lemon Tree Hotels ('LTH') understand the identification, assessment and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor and control the probability and/or the impact of unfortunate events. Risks can come from the uncertainty in financial markets, market conditions, threats from project failures (at any phase in design, development and operations), legal liabilities, credit risks, accidents, natural causes and disasters as well deliberate attack from an adversary or events of uncertain or unpredictable root cause.

LTH considers risk management as key to maintaining efficient and effective operations and enhancing the shareholders value. For LTH, the management of risk is an ongoing process integral to the management and corporate governance of the business.

LTH recognizes that risk is an integral and unavoidable component of business and cannot be totally eliminated but however LTH is committed to managing the risks in a proactive and effective manner so as to minimize any adverse fall outs threatening the existence of LTH.

RISK MANAGEMENT

The risk and safety management system adopted by LTH will enable LTH to identify problem areas with respect to regulations, competition, business risk, development risks, investments, acquisition and retention of talent, health & safety. Business risk, inter-alia, further includes financial risk, political risk, fidelity risk, legal risk, employee, guest, asset safety and safety of community and to establish a prevention system to safeguard the future.

At LTH, the adopted approach involves identification and characterization of threats, development of a safety policy, risk assessment, development and implementation of risk control strategies, consultation and training, followed by formulation, maintenance and review of strategies. The Principles of risk management should:

1. Create value
2. Be an integral part of the organizational process
3. Be part of the decision making process
4. Explicitly address uncertainty and assumptions
5. Be systematic and structured process
6. Be based on best available information
7. Capable of customization

The Board of Directors of LTH ("**Board**") determines LTH's tolerance for risk and is committed to a risk management system that balances the need to preserve long term values, prudently manages the hotel properties, maintain good relationships with partners and Joint ventures, and facilitates a culture of innovation. LTH's risk management system is designed to assist LTH to achieve its strategic and operational objectives with the vision, strategy, processes, technology and governance of LTH and provides for:

- a. appropriate levels of risk taking
- b. an effective system for the management of risk across LTH
- c. protection against incidents causing personal injury and property damage
- d. development of risk management and control plans to reduce or minimize unforeseen or unexpected costs

- e. ability to identify, prioritize and respond to risk in a manner that maximizes opportunities
- f. reliable financial reporting and compliance with laws, regulations and standards
- g. sound insurance management practice
- h. protection of assets from planned and unplanned events

The risk management function is supported by the audit committee of the Board ("**Audit Committee**").

RISK STRATEGY

LTH believes that risk cannot be eliminated. However, it can be:

- Transferred to another party, who is willing to take risk, say by buying an insurance policy or entering into a forward contract
- Reduced, by having good internal controls
- Avoided, by not entering into risky businesses
- Retained, to either avoid the cost of trying to reduce risk or in anticipation of higher profits by taking on more risk
- Shared, by following a middle path between retaining and transferring risk

For managing risk more efficiently, LTH would need to identify the risks that it faces in trying to achieve its objectives. Once these risks are identified, these would need to be evaluated to see which of them will have critical impact on LTH and which of them are not significant enough to deserve further attention. As a matter of policy, these risks are assessed and steps as appropriate are taken to mitigate the same.

RISK MANAGEMENT FRAMEWORK

Objectives must be clearly defined before management can identify potential risks affecting their achievement. Risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

The objectives of LTH can be classified into:

Strategic:

- Organizational Growth
- Sustenance and growth of strong relationships with guest/customers/clients/vendors.
- Expanding our presence in existing markets and penetrating new geographical markets

Operations:

- Consistent revenue growth
- Consistent profitability growth
- High quality hotel and guest services
- Attract and retain quality, trained employees and associates and augmenting their training

Reporting:

- Maintain high standards of Corporate Governance and public disclosure

Compliance:

- Ensure stricter adherence to policies, procedures and laws/rules/regulations/standards

In principle, risks always result as consequence of activities or as consequence of non-activities. Risk Management and Risk Monitoring are important in recognizing and controlling risks. The entirety of enterprise risk management is monitored and modifications made as necessary.

Controlling of Risk/Risk mitigation is an exercise aiming to reduce the loss or injury arising out of various risk exposures.

LTH shall adopt systematic approach to mitigate risks associated with accomplishment of objectives, operations, development, revenues and regulations. LTH believes that this would ensure mitigating steps proactively and help to achieve stated objectives.

LTH shall constitute a Risk Assessment and Minimization Committee with Functional heads as members. The Committee will submit its half yearly report to the Audit Committee/ Board about the measures taken for mitigation of Risk in the organization.

We consider activities at all levels of the organization, viz., Corporate level; Hotels level; Branch Office level; Development Site level, Subsidiary and Joint Venture level in the risk management framework. All these components are interrelated and drive the Risk Management System with focus on three key elements, viz.

1. Risk Assessment
2. Risk Management
3. Risk Monitoring

RISK ASSESSMENT

Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risk Assessment consists of a detailed study of threats and vulnerability and resultant exposure to various risks.

To meet the above stated objectives and for exploiting opportunities, effective strategies are to be evolved and as a part of this, key risks are identified and plans for managing the same are laid out.

RISK MANAGEMENT AND RISK MONITORING

In risk management and monitoring, the probability of risk is estimated with available data/ information and appropriate risk treatments are worked out in the following areas:

1. Economic Environment and Market conditions

The hospitality industry is prone to impacts due to fluctuations in the economy caused by changes in global and domestic economies, changes in local market conditions, excess hotel room supply, reduced international or local demand for hotel rooms and associated services, competition in the industry, government policies and regulations, fluctuations in interest rates and foreign exchange rates and other social factors. Since demand for hotels is affected by world economic growth, a global recession could also lead to a downturn in the hotel industry.

2. Socio-political risks

In addition to economic risks, LTH faces risks from the socio-political environment, internationally as well as within the country and is affected by events like political instability, conflict between nations, threat of terrorist activities, occurrence of infectious diseases, extreme weather conditions and natural calamities, etc. which may affect the level of travel and business activity.

Risks that are likely to emanate are managed by constant engagement with the Government of the day, reviewing and monitoring the country's industrial, labor and related policies and involvement in representative industry-bodies.

3. Competition

The Indian subcontinent with vast opportunities and potential for high growth has become the focus area of major international chains. Several of these chains have established and others have their plans to establish hotels to take advantage of these opportunities. These entrants are expected to intensify the competitive environment. The success of LTH will be dependent upon its ability to compete in areas such as room rates, quality of accommodation, brand recognition, service level and convenience of location and also to some extent, the quality and scope of other amenities, including food and beverage facilities.

4. Revenue Concentration

High concentration in any single business segment exposes LTH to the risks inherent in that segment. Prudent norms are being adopted based on which we can monitor and prevent undesirable concentration in a geography, industry, or customer. The quest for diversified activities within the existing realm of overall management after due consideration of the advantages and disadvantages of each activity is consistent with company policy of increasing business volumes with minimum exposure to undue risks. Concentration of revenue from any particular brand or segment of industry is sought to be minimized over the long term by careful extension into other activities, particularly in areas LTH has some basic advantage.

To counter pricing pressures caused by strong competition, LTH has been increasing operational efficiency and continues to take initiatives to move up the guest satisfaction scale besides cost reduction and cost control initiatives.

5. Inflation and Cost Structure

The industry in general has a high operating leverage. At organizational level, cost optimization and cost reduction initiatives are implemented and are closely monitored. LTH controls costs through budgetary mechanism and its review against actual performance with the key objective of aligning them to the financial budgets/model. The focus on these initiatives will further inculcate across the organization the importance of cost reduction and control.

6. Financial Reporting Risks

Changing laws, regulations and standards relating to accounting, corporate governance and public disclosure can create uncertainty for companies. These new or changed laws, regulations and standards may lack specificity and are subject to varying interpretations. Their application in practice may evolve over time, as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs of compliance as a result of ongoing revisions to such corporate governance standards.

LTH is committed to maintaining high standards of compliances, corporate governance and public disclosure and complying with evolving laws, regulations and standards in this regard would further help us address these issues.

Our preparation of financial statements in conformity with Indian GAAP and in accordance with the Accounting Standards issued by ICAI, requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates and judgments on historical

experience and on various other factors that are believed to be reasonable under the circumstances including consultation with experts in the field, scrutiny of published data for the particular sector or sphere, comparative study of other available corporate data, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These may carry inherent reporting risks. We believe that the accounting policies related to revenue recognition and Accounting for Income taxes are significant.

7. Risk of Corporate accounting fraud:

Accounting fraud or corporate accounting fraud are business scandals arising out of misusing or misdirecting of funds, overstating revenues, understating expenses etc. LTH to mitigate this risk by:

- Understanding the applicable laws and regulations
- Conducting risk assessments
- Instituting and monitoring code of conduct and Whistle blower/vigil mechanism
- Deploying a strategy and process for implementing the new controls
- Adhering to internal control practices that prevent collusion and concentration of authority
- Employing mechanisms for multiple authorization of key transactions with cross checks
- Scrutinizing of management information data to pinpoint dissimilarity of comparative figures and ratios
- Creating a favorable atmosphere for internal auditors in reporting and highlighting any instances of even minor non-adherence to procedures and manuals and a host of other steps throughout the organization

8. Legal Risk

Legal risk is the risk in which LTH is exposed to legal action. As LTH is governed by various laws and LTH has to do its business within four walls of law, where LTH is exposed to legal risk exposure. Focus is to be given on evaluating the risks involved in a contract, ascertaining our responsibilities under the applicable law of the contract, restricting our liabilities under the contract, and covering the risks involved, so that adherence to all contractual commitments can be ensured.

Management places and encourages its employees to place full reliance on professional guidance and opinion and discuss impact of all laws and regulations to ensure company's total compliance. Advisories and suggestions from professional agencies and industry bodies, chambers of commerce etc. are carefully studied and acted upon where relevant.

LTH has established a compliance management system in the organization and the quarterly compliance reports from functional heads and the hotels are taken and the non-compliances and delays, if any, are reported to the Audit Committee and the Board of Directors.

9. Compliance with Local Laws

LTH is subject to additional risks related to complying with a wide variety of national and local laws, restrictions. LTH strives to place robust process with the help of consultants to mitigate and minimize such compliance risk under municipal laws of the land.

10. Quality and Project Management

Our commitment towards total Quality Management is to forge the Human Resources of our organization into a team that promotes continual improvement in quality of hotels and services. Considerable focus is given to adherence to targeted dates and commitment to quality in every project and customer feedback is studied by adopting various methods including personal interaction, wherever required, during and after project completion.

11. Environmental Risk Management

LTH endeavors to protect the environment in all its activities, as a social responsibility and strives to avoid any situation causing a risk to the environment and community at large.

12. Human Resource Management

LTH's Human Resources (HR) Department will add value to all its Units and associate companies by ensuring that the right person is assigned to the right job and that they grow and contribute towards organizational excellence. Our growth has been driven by our ability to attract good quality talent and effectively engage them in right jobs.

Risk in matters of human resources are sought to be minimized and contained by following a policy of providing equal opportunity to every employee, inculcate in them a sense of belonging and commitment and also effectively train them in spheres other than their own specialization. Employees are encouraged to make suggestions on innovations, cost saving procedures, free exchange of other positive ideas relating to hospitality industry etc. It is believed that a satisfied and committed employee will give his best and create an atmosphere that cannot be conducive to risk exposure.

Employee-compensation is always subjected to fair appraisal systems with the participation of the employee and is consistent with job content, peer comparison and individual performance. Packages are inclusive of the proper incentives and take into account welfare measures for the employee and his family.

We seek to provide an environment that rewards entrepreneurial initiative and performance.

RISKS SPECIFIC TO LTH AND THE MITIGATION MEASURES

- 1) Business dynamics:** The key risk is variation of the occupancy rates including seasonal occupancy rates for certain key units.

Risk mitigation measures:

Based on experience gained from the past and by following the market dynamics as they evolve, LTH is able to predict the demand during a particular period and accordingly an advance operational policy be formed for maximum customer satisfaction and to mitigate any consequential losses.

- 2) Business Operations Risks:** These risks relate broadly to LTH's organization and management, such as planning, monitoring and reporting systems in the day to day management process namely:

- Organisation and management risks,
- Time, cost and quality risks related to development,
- Business interruption risks,
- Profitability

Risk mitigation measures:

- LTH functions under a well-defined organization structure.
- Flow of information is well defined to avoid any conflict or communication gap between two or more Departments.
- Second level positions are being created in each Department to continue the work without any interruption in case of non-availability of functional heads.
- Proper policies are followed in relation to maintenance of inventories of raw materials, consumables.
- Effective steps are being taken to reduce cost of services without compromising on the quality of the services on a continuing basis taking various changing scenarios in the market.

3) Liquidity Risks

- Financial solvency and liquidity risks
- Borrowing limits
- Cash management risks

Risk Mitigation Measures:

- Proper financial planning is put in place with detailed Annual Business Plans discussed at appropriate levels within the organization.
- Annual budgets are prepared and put up to management for detailed discussion and an analysis of the nature and quality of the assumptions, parameters etc.
- These budgets with Variance Analysis are prepared to have better financial planning and study of factors giving rise to variances.
- Daily and monthly cash flows are prepared, followed and monitored at senior levels to prevent undue loss of interest and utilize cash in an effective manner.

- Cash management services are availed from Bank to avoid any loss of interest on collections

4) Credit Risks

- Risks in settlement of dues by customers/travel agents
- Provision for bad and doubtful debts

Risk Mitigation Measures:

- Systems put in place for assessment of creditworthiness of customers/travel agents
- Provision for bad and doubtful debts made to arrive at correct financial position of LTH
- Appropriate recovery management and follow up

5) Logistics Risks

- Use of outside contractual sources/vendors

Risk Mitigation Measures:

- Exploring possibility of an in-house or better logistic mechanism if the situation demands

6) Market Risks/Industry Risks

- Demand and Supply Risks
- Quantities, Qualities, Suppliers, lead time, interest rate risks
- Interruption in the supply of products for use in hotels

Risk Mitigation Measures:

- Products are procured from different sources at competitive prices
- Alternative sources are developed for uninterrupted supply
- Demand and supply are external factors on which company has no control, but however LTH makes its plans from the experience gained in the past and an on-going study and appraisal of the market dynamics, movement by competition, economic policies and growth patterns of different segments of users of company's services
- LTH takes specific steps to reduce the gap between demand and supply by expanding its customer base, improvement in its product profile, delivery mechanisms, technical inputs and advice on various aspects of de-bottlenecking procedures, enhancement of capacity utilization etc
- Proper inventory control systems have been put in place

7) Human Resource Risks

Risk Mitigation Measures:

- Company has proper recruitment policy for recruitment of personnel at various levels in the organization

- Proper appraisal system for revision of compensation on a periodical basis is evolved
- Employees are trained at regular intervals to upgrade their skills
- Labor problems are obviated by negotiations and conciliation
- Activities relating to the Welfare of employees are undertaken
- Employees are encouraged to make suggestions and discuss any problems with their Superiors

8) Disaster Risks

- Natural risks like fire, floods, earthquakes, etc.

Risk Mitigation Measures:

- The properties of LTH are insured against natural risks, like fire, flood, earthquakes, etc. with periodical review of adequacy, rates and risks covered under professional advice
- Fire extinguishers are placed at fire sensitive locations
- First aid training is given to watch and ward staff and safety personnel
- Workmen of LTH are covered under ESI, EPF, etc., to serve the welfare of the workmen

9) IT System Risks

- System capability
- System reliability
- Data integrity risks
- Coordinating and interfacing risks

Risk Mitigation Measures:

- Maintenance department maintains, repairs and upgrades the systems on a continuous basis with personnel who are trained in software and hardware
- Password protection is provided at different levels to ensure data integrity
- Licensed software is being used in the systems
- LTH ensures "Data Security", by having access control/ restrictions

10) Legal Risks

These risks relate to the following:

- Contract Risks
- Contractual Liability
- Frauds
- Judicial Risks
- Insurance Risks
- Health and Safety Hazards

Risk Mitigation Measures:

- A study of contracts with focus on contractual liabilities, deductions, penalties and interest conditions is undertaken on a regular basis

- The Finance/Legal department vets and finalizes all legal and contractual documents with legal advice from Legal professionals/outside counsels as per the requirement
- Internal control systems for proper control on the operations of LTH to detect any frauds
- Insurance policies to be audited to avoid any later disputes
- Timely payment of insurance and full coverage of properties of LTH under insurance
- Regular medical check-up of the employees located at the hotels to avoid any cause, infection or spread etc. of any communicable diseases

11) Foreign Exchange and Interest Rate Risks

- Currency exposures in the form of Sundry Debtors, Sundry Creditors etc.
- Currency exchange rate fluctuations
- Interest costs fluctuation according to interest rate movements during the life of the loan
- Resetting of interest rates on an entity's loans from banks or other lenders
- Impact of interest rate on short-term investments
- Impact of interest rate changes on the value of long-term financial assets and liabilities

Risk Mitigation Measures:

- Company's bankers be consulted and suitable exposures in the form of limited buyers' credit and other instruments are evolved to mitigate exchange rate fluctuations as well as in interest rates tied to LIBOR and other like rates.
- Borrowing on fixed interest rate or floating interest rate for the period of the loan as may be suitable in view of prevailing conditions.
- If Borrowings on floating interest rate, protection from rising interest rates can be done by availing interest rate cap or option. Essentially this is like insuring against rising rates. If the rates rise, the borrower is protected. If rates fall, the borrower retains the benefit of the clearance in interest rates. As a borrower, a premium is paid for this protection from rising interest rates.
- Another way is to consider using an interest rate swap for borrowings on floating rates.
- On fixed rate assets should interest rates increase, terminate the investment prior to its maturity.

RISK TOLERANCE LEVEL

LTH's risk tolerance will always be limited by its focus on the need to maximize long term distributions and the fundamental long term value of its properties and services. LTH will adopt a risk management strategy that aims to identify and minimize the potential for loss, while also maximizing strategic opportunities for growth in enhanced service delivery and profitability.

ROLES AND RESPONSIBILITIES

(a) Board responsibility

The Board is responsible for the oversight of the risk management framework. This includes: policies and procedures related to risk management, risk profile, risk management and assessing the effectiveness of risk oversight and management.

(b) Audit Committee

The Audit Committee is responsible for advising the Board on risk management and compliance management and to assist the Board in fulfilling its risk management and oversight responsibilities.

(c) Risk Assessment and Minimization Committee

The Risk Assessment and Minimization Committee will drive the process of risk management and report new risks or changes to existing risks to the Audit Committee and will submit its half yearly report to the Audit Committee/ Board about the measures taken for mitigation of Risk in the organization.

(d) Function Heads, COO's and Hotel General Manager responsibility

All Function Heads, COO's, and the Hotel General Manager are responsible to ensure that systems, processes and controls in LTH and its hotels are in place to position identified risk at an acceptable level.

(e) Employee responsibility

All employees of LTH (if any) must report any new risks or changes to existing risks to their managers or supervisors as soon as they become aware of the risk.

(f) External auditor

The external auditor is responsible for providing an independent opinion of the financial results of LTH. In undertaking this role, the auditor also provides comments on the management of risk and assists LTH in the identification of risk.

REPORTING

The Risk Assessment and Minimization Committee must report new risks or changes to existing risks to the Chairman of the Audit Committee as soon as practicable after becoming aware of such risks. The intended outcomes of the risk management programme include:

- a) the establishment of a robust risk management framework and internal control system that enhances LTH's ability to meet its strategic objectives;
- b) improved operating performance and reliable internal and external reporting;
- c) increased awareness and management of risk;
- d) compliance with policies and procedures and applicable laws and regulations.

This policy will be reviewed at least annually by the Audit Committee to ensure its effectiveness, continued application and relevance.

DISCLAIMER CLAUSE

The Management cautions readers that the risks outlined above are not exhaustive and are for information purposes only. Management is not an expert in assessment of risk factors, risk mitigation measures and management's perception of risks. Readers are therefore requested to exercise their own judgment in assessing various risks associated with LTH.

The Policy is approved by the Board of Directors on 19.02.2015.