



Lemon Tree Hotels Limited

Q3 FY19 Earnings Conference Call Transcript

February 15, 2019

Moderator: Ladies and gentlemen, good day and welcome to the Lemon Tree Hotels' Earnings Conference Call. As a reminder, all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Anoop Poojari from CDR India. Thank you and over to you, sir.

Anoop Poojari: Thank you. Good afternoon everyone and thank you for joining us on the Q3 FY19 Earnings Conference Call of Lemon Tree Hotels Limited.

We have with us today Mr. Patanjali Keswani - Chairman and Managing Director; Mr. Kapil Sharma - Chief Financial Officer; Mr. Vikramjit Singh – President and Mr. Prashant Mehrotra – Chief Revenue Officer of the company.

Before we begin, I would like to state that some statements made in today's call may be forward-looking in nature and a detailed statement in this regard is available in the Results Presentation shared with you earlier.

I would now request Mr. Keswani to make his opening remarks.

Patanjali Keswani: Thank You, Anoop. Good afternoon and hello to everyone and thank you for joining in on this call. I hope all of you have had an opportunity to go through our results presentation which provides details of our operational and financial performance for Q3 & 9M FY19.

We have delivered a healthy performance in these 9 months with a topline growth of 15.2% Year-on-Year to Rs. 4,064 million. We have been able to drive an 8.5% Year-on-Year increase in ADR in 9 months of FY19 while occupancies have improved 60 bps to 75.9%, resulting in a healthy RevPAR growth of 9.3% Year-on-Year. Our occupancies have actually improved by 130 bps, excluding brand new hotels we have opened in Q3 which are Red Fox, Dehradun and Lemon Tree Premier, Pune. Our strong cost control in operating leverage resulted in an EBITDA growth of 29% Year-on-Year to Rs. 1,272 million in 9M FY19. EBITDA margins expanded by 339 bps Year-on-Year to 31.3% in 9M FY19.

For Q3 FY19, total income stood at Rs. 1,452 million, up 9.5% as compared to Rs. 1,326 million Q3 FY18. ADR increased by 4.8% Year-on-Year in Q3 FY19, occupancy has reduced 350 bps this quarter on account of new supply of close to 300 owned / leased rooms added during the quarter. Excluding the new supply of



rooms added during the quarter, the drop in occupancy is 156 bps. Total expenses increased by 5.3% in Q3 FY19, of which about 4% was account of new inventory. This led to an EBITDA growth of 18% Year-on-Year in Q3 FY19 to Rs. 508 million while EBITDA margins expanded 260 bps Year-on-Year to 35%. PAT stood at Rs. 139 million up 34% Year-on-Year while cash profit increased 18% Year-on-Year to Rs. 274 million. Fees from managed hotel stood at Rs. 64.2 million in Q3 FY19 which is about 4.4% of our total income and which is higher by 58% as compared to Rs. 40.9 million in Q3 FY18 which was then 3.1% of our total income.

Our current operational inventory comprises of 5,342 rooms of which 3,570 are owned/long leased and 1,772 are managed. We have added nearly 300 owned rooms during the quarter, 91 rooms at Red Fox Hotel in Dehradun which was commissioned in October and 201 rooms at Lemon Tree Premier, City Center, Pune which was commissioned in December 2018.

Our active development pipeline which is expected to be operationalized over the next three years consists of 1,240 owned/long leased rooms and 2,218 rooms under management contracts. Of these, 1,420 rooms will be operational by the end of Q3 FY20 of which 663 rooms are owned and 832 are managed. The owned room addition includes our 303 room Lemon Tree Premier Hotel at Andheri East in Mumbai which is now complete and we are in the last leg of approvals and expect to launch soon. Further 140 rooms will be added in Kolkata and 139 rooms in Udaipur. We have a large supply of high value inventory now getting operationalized and demand dense regions with high occupancies and ADR which coupled with our anticipated price hikes and our operational cost efficiencies should drive strong cash flows in the coming years.

Going in to Q4 demand for rooms is looking very robust from the back of planned conferences, events and so on which makes us confident of a much stronger performance. We believe the hotel industry is at an inflection point given the increasing occupancy levels across the country and favorable demand supply mismatch in the mid-priced hotels sector. We expect better price hikes going forward resulting in robust RevPAR growth.

We are well poised to capitalize on the changing industry dynamics on the back of a very large inventory of rooms moving towards steady state that we are opened in the last three years during the down cycle, higher pricing, operationalization of high value inventory in the coming quarters and our cost leadership.

We are also very happy to report that we have signed a new joint venture with Warburg Pincus which marks our foray into student housing and co-living spaces for the millennial population. Our focus will be on students, young working professionals and entrepreneurs. We believe this is an exciting space and a huge opportunity for a large organized player like us to tap. Our capital investment in this business in the initial years will be minimal as we will adopt an asset light strategy to test the market and grow the business.

On that note I come to the end of our opening remarks and would now like to ask the moderator to open the line for questions and answers.

Moderator:

Thank you.Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.



Manish Ostwal: My question is with respect to the pricing trend in the industry and against your expectation whether the pricing is better or how is that? Can you comment on that thing, sir?

Patanjali Keswani: Okay so if you look at our average daily rate growth, really our business pricing is a series of steps over time. So you have pricing in H1 which is different to pricing in H2 then the pricing for the following H1 comes down because high value customers, who come in winter, do not visit in summer. So you imagine it as step 1 H1 followed by a hike which is the price hike in H2 then it come down a little bit in H1 of the following year and then again goes up in H2 of the following year.

So we look at it from that perspective. We had a large price hike last year and if I recollect it right about 14% so it was a high base. In fact we went against industry wisdom and raised the prices fairly significantly. So now if you look at Slide 9 of my presentation to you which is performance highlights in the Q3 FY19 was 5% higher whereas if you look at this year from 9M FY19 which included the hike of the previous year our increase in Q3 FY19 was 8.5% from Rs. 4,099 to Rs. 4,465.

You must keep in mind that we operate in 31 cities so in some cities there is still an oversupply situation playing out and therefore if you look at it on an aggregate basis, let me share that in some cities our prices remain the same. But in the cities that are now displaying total consumption of supply there we have been able to get in fact in some cities price hikes of 15% to 25%. So the broad point I am making is that we are not dissatisfied with the price hike.

One other reason for the price hike not being as high as perhaps some people hoped for was because the two best months in a year are November and February. And just as an inside tip, if Diwali is in November, then it kills that part plus / minus ten days of November which is traditionally a very high occupancy and high rate period. So this quarter we had Diwali on 7th November which was in fact a Wednesday and if you look at interestingly our occupancy around Diwali this year, it was in the mid-30% to early-40% whereas last year it was in the early 90%. So that actually depressed our occupancy.

Last year Diwali incidentally was on October 19th which was a Thursday which is not traditionally a high demand month compared to November. So if you do the weighted averages and I think we should put out a note on this Kapil, you would see that the impact of Diwali alone was equivalent to a 60% drop in occupancy for about ten days in November as against last year in October when the difference in occupancy was only 20% over ten days. So we just adjust for Diwali like this year coming year Diwali is I think 29th of October which is Sunday.

This year of November will be phenomenal. But last year November was very badly affected by Diwali. And that also affected our pricing because when occupancy drops so significantly nobody travels for business during Diwali and we had to drop pricing on the online channels to stimulate demand and that led to some drop in the pricing of the entire company.

Manish Ostwal: Second question on this the likely JV of Warburg Pincus, so what is our target market size in that category and likely investment by Lemon Tree?

Patanjali Keswani: Okay so you see the agreement we have signed is a joint equity investment in Phase-1 of \$200 million which is roughly Rs. 1,500 crore. Now the way we look at this business is the following, so why has Lemon Tree got me into this? I think I should explain that. First point is that it is a stable annuity business totally unlike



the hotel business which displays high elements of volatility. So it is actually counter cyclical in that sense for us, for our high cyclicality it is a very stable and like an annuity business.

Number 2, it is an adjacent business and a very logical brand extension for Lemon Tree for which we will charge fees to this joint venture. Now what do I mean by brand extension. Well we are creating a new brand and for the moment let us just say it is XYZ so this new brand will be XYZ co-living or XYZ student housing by Lemon Tree Hotels, and it will target people who are actually our customers, future customers which is students and existing customers who are young working professionals in high rental regions in India.

Now clearly I have gone across India in the last one-and-a-half months and to China where Warburg Pincus has invested about \$1 billion in three large companies focused on this space. What have I observed? At the sub-scale, relatively fragmented market in India which is very capital light, starved of cash, is operating at 85% to 95% stable year round occupancies and our expectation is that given our development capability and our operational cost capability as well as our relatively high quality service delivery, we feel we can actually capture a significant part of this market.

The market is estimated at roughly 10 million beds a year which is based on current migrant student population in India and perhaps another 10 million beds for young urban professionals who migrate to the top ten to twelve cities in India. Our expectation is that we will be able to target a yield of 14% to 15% on investment. So if you take the business model, once this business is stable it gives a pretty high return on capital deployed. Initially our plan is to go asset light, so what we intend to do is lease existing distressed buildings across India and tie up with certain universities with whom we are in advanced talks. Universities provide us a captive audience which is the students in the university because parents who typically decide where the kids stay are very focused on safety, security and in campus residence. So we have now talked to a number of universities and are close to signing some deals there. As relates to the way we intend to go in, our plan is very simple. The first 10,000 beds we do, at least 80% will be leased. The implication of lease is very simple. The capital deployed by us will be less than 10% of the asset value. The capital deployed by the joint venture will be less than 10% of the asset value and will really go towards repurposing and converting these buildings into our design. So once we are confident of the returns and sure of the market, which I expect will happen in the next 12 to 24 months then we will look at scaling up very rapidly when we are confident of returns on actually capital deployed in ownership.

Moderator: Thank you. The next question is from the line of Heema Patel from Anand Rathi. Please go ahead.

Heema Patel: I wanted to ask about the capex plans like what amount of capex has been incurred in FY19 and what is the further capex till FY20 can you give the amount for that?

Kapil Sharma: If we talk about say for 9M FY19, we have already done around Rs. 150 crore capex. Now as you know we have already opened Pune property and other property was leased and does not require much capex and next property which is opening is in Mumbai where most of the capex is already incurred.

So next year the major capex is going to be incurred in the Calcutta and Udaipur properties which would be also in the range of around Rs 80-100 crore for these two properties, right. And then the major capex requirement for Lemon Tree



Premier, International Airport, Mumbai project (MIAL) will come in a later stage, not majorly in the next financial year.

Heema Patel:

Okay. My second question is about the land bank of Mumbai Airport property. I cannot see the land amount shown in the CWIP. Neither I can see it in my investment so the land has been purchased like in 2008 but where it is shown?

Kapil Sharma: Airport property was not bought in 2008, it was bought in 2014. But actually why you are not seeing is because it is on a very long lease and it is a similar arrangement which we have in the Delhi International Airport and it is just to correct you that it is not a land bank, generally we do not create any land bank, it is a property where the project is already on. So we are under construction as of now. All the approvals related to construction are in place and as far as balance sheet is concerned you are not seeing it because the amount paid is a security deposit and it is rentals which will be getting capitalized during the construction period and it will not be shown as an owned land.

Heema Patel:

So it is an owned land or it is leased land?

Patanjali Keswani:

It is a leased land, it is taken from Mumbai International Airport which is a joint venture of GVK and Airport Authority of India and like in Delhi Airport these parcels of land have been given to us and to others on the basis of a 60 year lease, 30 plus 30 and we have invested in the deposit about Rs. 170 crore and right now up to date our total investment in the property is Rs. 225 crore.

The property is under development, construction is being done by ShapoorjiPallonji and we expect we will be out of the basement in the next six months and will open this hotel in calendar year 2021. It will be I think as you might know India's largest hotel with 670 rooms because we have converted the commercial space to rooms because the average occupancy in that market for a 4 star hotel is about 85% to 87% at about Rs.7,000 ADR.

Heema Patel:

Okay, my next question is about the margin expectations for the next three years, can you give some light on that?

Patanjali Keswani:

I do not want to give any guidance on that. Let me instead tell you how I see it and you can then do your extrapolation accordingly. If you see this year, so Q3 has been poor and I tried to explain it broadly to everybody that if you look at October this financial year we did 58% in FY19 and 38% in FY18 around Dussehra and Diwali in October. So we were 20% better this year than last year. Whereas in November we used to do 92% occupancy in the first ten days and we ended up doing 40% this year because nobody traveled.

So that was the real impact and as I had mentioned earlier, pricing went down because we had to stimulate demand of a segment which we normally do not focus on which is the leisure market. Now if you also look at our hotels this year and this is relevant for you to consider when you do your projections going forward, the same hotels that we had this year compared to last year account for 89% of our own inventory and they did over 75% occupancy but the 11% that is the new hotels that we opened Pune and Dehradun did 45% occupancy because they were brand new.

So the weighted average came to 72.8% and the real occupancy of our existing hotels was a little over 75%. Now if you look at this following quarter, and this is our rough calculations we will grow in income by at least 20% this quarter, perhaps



25%, so on a full year basis our growth in income will be about 16.5%. You will get a clear idea of how we operationalize and stabilize hotels when at the year-end after Q4 we will give you the breakdown of infant, toddler, and adult hotels.

Our EBITDA growth also for the full year we expect will be at least 27-28% growth. Our PAT growth will be not less than 150% versus last year and our cash profit will grow by at least 34-35% because depreciation is actually nearly the same as the previous year. Now if you plug in these figures and take Bombay, Calcutta, Udaipur as opening in the next nine months and assume even a 9% to 10% price hike going forward, you will get certain I think very interesting figures if you do your own projections for the next three years.

However, when Mumbai International Airport opens two-and-a-half years later, my minimum expected EBITDA from that hotel is Rs. 150 crore. So you will have to top that up with that. Take into account our managed fee income is growing quite healthily at 50% with no capital deployed and we expect that to continue going forward for the next three years too.

Heema Patel: My next question will be about the capital deployment strategy that you have applied through APG so like APG invested in Fleur so I would like to know the valuation metrics of the investment inflows?

Patanjali Keswani: It is very simple. Today you have a benchmark, I think Chalet Hotels listed at roughly 17x current and 15x forward. So you can plug in the figures for Fleur and if you apply it appropriately you will find that Fleur at a similar valuation will give a return on equity in excess of 17% CAGR.

Moderator: Thank you. The next question is from the line of Deepika Mundra from JP Morgan. Please go ahead.

DeepikaMundra: Just firstly on the management fee income, what would be the nine months number?

Patanjali Keswani: Rs. 13.7 crore.

DeepikaMundra: Thank you and secondly on the co-living project, now typically rental yields in India are close to around 3% odd, so how would you explain a 14%, 15% yield on investment given that after 8,000, 10,000 rooms it is going to be more an asset heavy business?

Patanjali Keswani: Good question. Thank you Deepika. Let me explain this. If you look at buying land and if you look at a typical developer today development returns are in the range of 12% to 14% that is the only time a developer builds a building and leases it. We have talked to a number of people, we have looked at buying out buildings and typically the developer is ready to sell a building you will be amazed to know at between 6% to 7% return on his capital, because he is planning to sell, once I lease it for say 30 years or 40 years he is planning to sell it in rental units to retail customers at a 3.5% yield.

The retail customers who I spoke to said that they expect a capital appreciation of 5% to 7% and a rental expectation of 3% to 4% so they are very happy. Of course when you lease, we have to amortize our investment, but as I had mentioned earlier our expected investment is only 10% in the overall capital value of the asset. So you do the economics there and let us assume we arbitrage the fact that the owner wants 5% to 6% of a new asset, and we are fairly confident of getting a 9%



to 10% yield in that asset. Then the arbitrage is for 10% investment we actually capture up to 40% of the rental value. Now let us go forward to asset ownership. In asset ownership our expectation of return is about 11% but our expectation that is on pure asset, but if we wear the hat of also the managers of this asset, we expect another 2.2% to 2.4%. So the first few projects we expect will be 13%, 13.5%. Why am I saying this? Because a typical rental place is very inefficiently designed in India today, they are designed as apartments and there is a lot of wastage of space. A normal person stays in say a 400bedroom carpet area which is maybe 600 square feet super built up this person spends 90% of their time in less than half the space which is the bedroom and the bathroom. They spend much less time in the living room and the kitchen, so our plan is very simple, as is common in China and in Hong Kong, we will give you a very small very efficiently designed bedroom and bathroom which will typically be less than a 120 square feet. This will be your private space for sleeping, for going to the loo and so on. And we will take out 25 square feet per unit into a common area so assume a 500-bed facility will have 60,000 square feet in sleeping areas and roughly another 10,000 to 15,000 square feet in common areas which will be very nicely designed, very social. We will make sure that it is a hub and like what has happened in China and Hong Kong we are very confident we will be able to attract young working professionals in this space.

So what are we really offering? We are offering 150 square feet per person. But the facility will be weighed against his option to rent a 400 square foot apartment and if you look at it from that perspective we are very confident of a minimum 13% yield. Incidentally let me share with you in China, Warburg invested I think about \$250 million, \$300 million in a company called Mofang. I went to see it about a month ago and I discovered that in one-and-a-half years from 1,000 beds when Warburg invested, today they are at 80,000 beds and they are achieving similar yields.

Moderator: Thank you. The next question is from the line of TusharSarda from Athena Investments. Please go ahead.

TusharSarda: I wanted to know in the co-living spaces are your focus on student housing or on the working population?

Patanjali Keswani: So student housing is a much larger opportunity currently. As I said there are 10 million migrant students who need accommodation and we are looking at as I said partnerships with universities across India and I think in the next six months we will be making a few announcements because this is a captive clientele. We are agnostic in the sense that actually student housing is a subset of co-living.

Co-living is accommodation transient to long term accommodation options for young people who are interested in renting rather than buying because today if you look at it, rental yields are 2%, 3%, 4% versus purchase, when you have purchase, you have EMIs which could be as high as 10% of the total capital value.

So we are getting on an aspirational ship which is very evident which is sharing or renting rather than buying. To answer your question therefore we are open to both, but I think that the co-living opportunity will only exist in ten cities in India where there is traffic density and therefore people who stay one or two hours away would much prefer to shift to a co-living apartment close to their place of work, and where the rental values are high and capital values even higher. So Bombay, Bangalore, Delhi, Gurgaon these are obvious markets.



TusharSarda: No, I was asking from the point of view of that students will have limited purchasing power as compared to a person who has a job and he is working because he will be the ability to spend a little more?

Patanjali Keswani: So if you do the demographics of students, interestingly students who go to government universities you are right, have very low purchasing power. But students who go to private universities, there is a very interesting formula which we have discovered, which is common, whether in India or in China which is that what you spend on your tuition about the same you are willing to spend on your housing. So we went to a university in China where the tuition was x, the housing was also x. So in India obviously the obvious demographic is to go after universities where the tuition is large enough to make sense for us to build student housing there.

TusharSarda: So when you talk of this market you are looking at people who are able to pay this, who are going to the private universities?

Patanjali Keswani: Yeah, but let me also explain that we have got four designs, design one is a semi-private dormitory. That can handle a rental of Rs. 6,000 to Rs. 7,000 per month. That is the market we think is about 4 million to 5 million people, students. Then we have what is called shared rooms with on suite bathrooms, which is a single bathroom that is typically at Rs. 9,500 to Rs. 11,500. A slightly larger room and a little more up market can go to Rs. 13,000 to Rs. 15,000.

This is excluding meals but students expect meals also. So if you include meals it will be another Rs. 3,000 plus. So we have done segmentation and in fact the universities we are talking to operate across all three. So we will be trying all three. And we will try and obviously find the right model then.

Moderator: Thank you. The next question is from the line of Hardik Patel, an individual investor. Please go ahead.

Hardik Patel: The first question is on Andheri hotels. You are scheduled to open that in January but we have pushed it to April, so what is the main reason for that, sir?

Patanjali Keswani: I think you should ask the Bombay Municipal Corporation. So the hotel is fully ready and if anybody wants to go they are welcome to go. It is an absolutely beautiful hotel. We are very confident that it will give a minimum EBITDA when stable of Rs. 45 crore plus, which is Rs. 15 lakhs a key by the way. And the whole issue was we got everything ready and then last minute some three, four fellows in the Bombay Municipal Corporation said you have to also provide a sewer line here. You have to also do this, you have to do that.

And see these are last minute. You cannot even fathom why they did not do it earlier because about six months ago we went to the corporation and said look our hotel is getting ready what are the final approvals required for occupancy? So they gave us a list of about 82 approvals, we got them all and now suddenly there are these four more approvals.

So it is a real tragedy in our country that a Rs. 300 crore investment with employees fully ready is lying empty because of last minute demands and the occupancy certificate which is actually what we are applying for now, they are telling us will take 45 working days. When we asked them earlier they said 20 days, so you know in that sense we are at the mercy of the ease of doing business in India.



Hardik Patel: Yeah sir, that is really unfortunate. The second question is the student housing the contribution that Lemon Tree has which is a 30% share, shall we plan on funding it via debt the entire amount that is the initial investment is I think around Rs. 1,500 crore is what was mentioned so about Rs. 450 crore?

Patanjali Keswani: So somebody asked me a little while back that how do you see Lemon Tree going three years out? So what we did is a very simple thing. So you see to me debt is anathema. I hate debt. So what I actually talked to Warburg Pincus about was I said look initially let us go asset light. Let us validate the model. And in order to scale it is obviously better to acquire buildings on lease rather than buy or build buildings. So our plan is very simple. We are looking at our cash flows five years out on a fairly conservative basis. Our expectation was, this is a forward statement, that we would be writing down the entire debt of Lemon Tree Hotels assuming a 7.5% growth in pricing in the next five years and the operationalizing of all our hotels. We would write Lemon Tree's debt to zero by 2023. However with this joint venture, we are planning to use mostly free cash flow to fund this joint venture and therefore we expect that our repayment of debt will be kicked forward to 2024. That should tell you we expect very, very significant cash flows from this year 2020 onwards, and we are fairly confident that we will not increase debt significantly. It will be very minor.

Hardik Patel: Okay but this Rs. 1,500 crore is at one go or this will be a gradual investment?

Patanjali Keswani: No, it is not Rs. 1,500 crore, the deal is for Rs. 1,500 crore of which Lemon Tree has to put Rs. 450 crore and this can be deployed over the next four years and it will be deployed as and when required and since we are very, very aware of the fact that any capital we deploy there, we have no recourse to the cash flows of that company. We will be very careful about how we allocate capital there. But to broadly answer your point, next one, one-and-a-half years we do not see a deployment of more than Rs. 30 crore, Rs. 40 crore by Lemon Tree.

Hardik Patel: And just one last question on the same thing is I read somewhere in your interview where you mentioned that some of these beds actually cost Rs. 8 lakhs and whereas our model will be under Rs. 1 lakhs so that is only for the leased model?

Patanjali Keswani: That is the leased model. So leased model see it is a question of what are you taking on lease. Fully equipped, fully furnished, warm shell or is it a cold shell, so broadly we expect a cold shell will cost us Rs. 4 lakhs to Rs. 5 lakhs a unit, a bed. A warm shell will cost us Rs. 3.5 lakhs and a generally fully fitted out will cost us Rs. 1 lakhs. Our expectation is that our average price across dormitory two shared, on suite bathrooms and two shared larger rooms on suite will be between Rs. 11,000 to Rs. 13,000 net of food. We expect that we should not have to pay.

So we are amortizing so we put in Rs. 1 lakhs or Rs. 3 lakhs or Rs. 5 lakhs we will amortize it over the length of the lease and put an imputed cost to that capital of 12% to 13% based on interest rates. So let me give you an example. The way we look at it is as a waterfall. We are saying that if we invest Rs. 3 lakhs per room and the lease period is say 20 years, then Rs. 15,000 a year is amortization and at 12% we need Rs. 36,000 more for this. So basically, we need Rs. 50,000 a year return just for the capital we deploy.

Then if we are paying him a lease rental per bed of say Rs. 60,000 then on this Rs. 110,000 we need to take out expense as whatever are the expenses which are typically another 15% so say Rs. 135,000 and then we want a management return of 20% on this which means Rs. 152,000 which is say Rs. 14,000 a bed which means that if we charge Rs. 15,000 at roughly 90% we should achieve our target.



So we have what is called a waterfall approach. We very successfully deployed this in Lemon Tree and I have no doubt that this business model will extend very nicely into this business. The further advantages as I mentioned earlier it is an annuity business, the average occupancy to every single place I went to is about 90%. So we see no reason why we will not be able to achieve that and we will be market makers that I can promise every investor here, that we will create an absolutely stunning new category in India.

Moderator: Thank you. The next question is from the line of Gaurav C, an individual investor. Please go ahead.

Gaurav C: Sir, my question is I just wanted to understand the reason for the tie-up with Warburg in the co-living space, so I get the opportunity size which is there. So as you said in the next one and one-and-a-half year you will do asset light and the kind of capital required is very minimal. So I just wanted to understand why dilute at such a high percentage at the concept stage itself, just wanted to know your thoughts?

Patanjali Keswani: Okay so very, very good point. So let me confess something to you. I personally did not consider student housing and co-living as an investment because we had enough on our plate and I know every investor listening to me in the wider world wants me to grow very fast but not deploy any capital. So this is an inherently contradictory unfortunately contradictory thing. So you know as a company we have no recourse to external cash flow.

So if you ask me the most important risk that me, Kapil, Vikramjeet, that we look at is debt okay and I am so glad that NCLT and so on has come in because now it makes it a more level playing field for us. So we are very focused on our ability to service any debt that we take. Now student housing did not cross my mind. A few months ago after we went public the senior leadership of Warburg came to meet me and said look we are going to do this, we have done this in China, it is an enormously successful model and we have comfort with you so you have the three key things that we are looking for, which is number one, you have a brand which people in the mid-market are very familiar with and are happy with.

Number 2 is you have operational/cost efficiencies, and number 3 you have a large development team because now that Lemon Tree's CAPEX cycle is getting over, with the development of MIAL what are you going to do with the 70 guys who are trained to deliver high quality and good prices in projects. So I said here's the deal. We will come in and since they talked about a minimum investment of \$200 million I said look I do not want Lemon Tree to take more than 30%. So let me explain why. I am a person who likes to build optionality.

Lemon Tree always has the option that five years from now when there is a lot of cash being generated by the company on an annuity basis and we are not deploying capital, in construction or development of new hotels, what will we do with this cash? So there are tax effective ways of doing share buybacks, there is dividend and then there are also opportunities which we can leverage this cash with where we feel shareholders will get a great return. So I told them that we will take 30% now but I do have the option later that I will buy them out before we take this entity public.

So the plan is very simple. The first deployment is \$200 million. I expect it to take four years the next deployment will be maybe two years after that because the interesting model is that if I get a 12% yield on a stable basis I can borrow roughly 5x of that without any risk. So let me assume I deploy \$200 million I can borrow



and I get a 12% yield I can borrow \$300 million more without any equity required on a no risk basis. So we are talking even in Phase-1 of a \$0.5 billion capital deployment which my reckoning is will take four to five years. If it really works well and I am fairly confident it will then we will redeploy another \$200 million, that is another \$0.5 billion.

Now at that point I will try obviously if we are confident about it Warburg is a lovely partner and we will look at buying some stake out from them and perhaps consolidating it into Lemon Tree. So I have kept this option open it is always there. But let us see how it goes.

Gaurav C: Here the only concern which probably an investor has is the execution everything is going to be done from Lemon Tree and the capital deployment is fairly minimal in the first one-and-a-half years when the proof of concept would be tested. So the valuation is pretty high at the initial stages and when you buy back when the concept is proven, the investment might not get the benefit of it is the concern which probably I had?

Patanjali Keswani: You know I actually wanted, you are absolutely right, I wanted 51% but Warburg said they want to deploy at least \$200 million. Now I was not happy about the fact that I would have to put in \$200 million okay. So I was trying to find a way out, now one thing which is perhaps not reported is that we expect a yield of 14% okay. Let us assume we do not achieve it, we achieve 12%. We get 2% of the yield or EBITDA as our fees for lending our brand name. So here is how I look at it that if \$0.5 billion is deployed and there is a \$70 million or \$60 million rental yield Lemon Tree will anyway charge \$1.2 million to \$1.5 million for lending its name.

So it is a currently a bit of an asset light we are moving into this space a less risk way, and the way I see it is if in \$500 million we are deploying \$60 million and I am at least getting \$1.2 million to \$1.5 million out I am getting some cash out okay the rest is of course embedded in the company. So I do not want to frankly I do not want to say I did not want 51% but I felt on the balance that it was safer to go to 30% and a long term maybe we will only be 26% strategic shareholders and we will take this company public and still manage it. So what opportunities arise in future I have no idea, but at current levels I was not willing to deploy a \$200 million because I would have to commit that \$200 million.

Moderator: Thank you. The next question is from the line of Shriram R. from Sundaram Mutual Fund. Please go ahead.

Shriram R: If you could comment on the rate hikes taken for the large corporates and the SMEs?

Patanjali Keswani: So see I do not have the exact numbers here but by and large for large corporates the rate hike would be 3.5%, 4%. Or maybe 2.5% to 3.5% I am not sure but about say 3%. For SMEs it would be say about 7% and for retail it would be higher but the weighted average came down because of the ten days of Diwali we gave a lot of staycation offers which were at 60% of our ARR. So the weighted average I think is about 8% to 9%, one third of it was at 4%, one third was at 7% and I would assume one third is at 13% - 14%.

I would like to request all investors to keep one thing in mind. We are growing very, very, very fast. We are now at that fly wheel stage where we will be able to leverage our brand, our management expertise, our development capabilities and I have no doubt that within the next year or two there will be enough large



institutional long only investors who will come to participate with us even at the asset level, which will enable us to redeploy significant capital or unlock it.

But every quarter there will be little jhutkas because when I open Bombay for three months to six months Bombay will not be stable. Now I have opened Pune. Pune is doing 40% odd occupancy and Pune is negative cash for me today. But in six months it will be positive.

So one of the problems with high growth is that I have three types of hotels, those which are stable, those which might give me 13% 14% ROCEs then there are some hotels that give me 6%, 7% and then there are some hotels that give me minus 2%, minus 5%. And therefore, the weighted average may look depressed but the reality is where we all stabilize and price hikes happens then we are talking 16%, 17% ROCEs. So keep that in mind when you do your modeling on our business because we are not a business that is not growing, we are deploying capital still.

Moderator: Thank you. We will move on to the next question that is from the line of Kishan Shah from Vriddhi Securities. Please go ahead.

Kishan Shah: I would just like a general industry overview, like at what point in the cycle are we right now? I think in your presentation you have mentioned that we are at the inflection point, so maybe you could just throw some more light on that?

Patanjali Keswani: So if you read the STR report that we commissioned when we went public in our prospectus, STR actually gave certain forward-looking numbers. The key point is that significant price hikes happen in India which are typically 2x to 4x of the inflation rate. So we are talking 8% to 16% price hikes when you reach 65% to 68% occupancy. But there is a lag effect of one year because the market it is so fragmented actually waits to confirm to themselves that there is demand because fundamentally we have been so whipped in the last ten years that there is a lack of confidence among most hotel companies in India.

So one year must pass and then when some confidence creeps back pricing goes up. My reckoning is that top of the cycle that is 70% or higher occupancies will hit India somewhere between late 2020 to late 2021. I am not able to predict exactly when it is a function of many things, including confidence, the start of the private CAPEX cycle and so on. So when that happens typical price growth is 6x to 8x of inflation rate. And you can check this back in 2003, 2004, 2005, 2006 where price hikes were routinely 30% 40% a year.

So I cannot predict unfortunately but what I am very sure of is that in the next two years it will hit the top of cycle and re-pricing will start happening as has already begun by the way in Delhi Airport where we have taken prices up by about 20%. So it has started happening but this will spread across India over the next two, two-and-a-half years.

So one of the big things Lemon Tree is looking at very opportunistically is without risking or straining our balance sheet can we do some level of consolidation in the next one year? How can we acquire inventory whether on management, whether on lease, whether opportunistically by inventory where we think we can capture this upside?

Kishan Shah: Okay. And my next question is that when we look at our market share there is a slide in our presentation where the market share is given for FY18 and the



expected market share this year. So there are certain cities where our market share is falling by maybe 1% or 2% and there are certain cities where it is increasing so where there is falling, is there any additional capacity that we are expecting that would come up?

Patanjali Keswani: Jaipur is going to grow by 10% so we from 11% will become 10% similarly Ahmadabad. Mumbai is so difficult to put up capacity that we are very pleased that we will control one in six rooms in Mumbai by another two years. Pune we have opened our hotel so now we have 9% of the 11% but some more capacity is in Pune which is a very strong market so we will stabilize at 9%. Goa we are remaining the same, Bangalore some more inventory is opening we are trying to actually acquire some of that inventory which will be on a long lease so in this case this 9% will go up to 11% rather than go down to 8%.

Delhi NCR we control one in six rooms. Calcutta we are opening our hotel so we will be one in twelve rooms, Hyderabad I am very happy with because it is a market which is growing very well and we control one in five rooms. Chennai we control one in twenty five rooms and this might go up because we are looking at certain leases there too.

So by and large we are very happy with our diversity and we are very happy that we are overweight on Bombay, Delhi and Hyderabad. We would like to be a little more over weight on Bangalore so we are looking at you know trying to acquire some stuff there.

Kishan Shah: Okay. And what about international regions like do you see to expand in any regions particularly?

Patanjali Keswani: So we found a few million Indians every year go to Dubai, to Kathmandu and to Bhutan. So if you notice that from the last I think we have grown from the last three months we have added six hotels to our managed portfolio one is Bandra Kurla complex actually in Bombay which would be of course a very profitable deal. There we are trying two hotels one in Thimphu, one in Dubai. So in Thimphu we will now have two hotels, Dubai we will have a very nice 114 room hotel beautifully located, I have seen it.

And then we are going to Pune, Bhubaneswar 76 rooms and Dindi which is near Amravati so we have added another 400 rooms to the managed portfolio which is the equivalent of adding 60 own rooms. So this is our portfolio as of January in fact but we are about to hopefully sign quite a few more in the next twelve months.

Kishan Shah: Okay. Just one final question. It is not a question actually it is just kind of a feedback that I visited a few of your hotels two in Ahmadabad and one in Chennai. So the management and the service that they provided is really, really good and I was amazed by the way they cater to the customers and the way they managed. So I think you are all doing a great job and congratulations again on the numbers and all the best for the future.

Patanjali Keswani: So let me tell you an interesting thing. 30% of our employees we have hired are unemployable. We have taken them, we have given them jobs, 20% of them are people with disability and this strategy has played out very well for us because our customers thank you for being one, are actually supporting our brand because we are India's largest employers of people with disability today.



Kishan Shah: Yeah and I think if I am not wrong, you even adopt pets also so I think that was a real plus for me because I am a pet lover myself.

Patanjali Keswani: We have only 152 dogs which is about 2% of our employees but we plan to raise it.

Moderator: Thank you. We will move on to the next question that is from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta: In terms of your management contracting business I understand your nine months revenue would be around Rs. 14 odd crore? What could be the PBT contribution?

Patanjali Keswani: That is correct. 70%.

Aadesh Mehta: Okay so around Rs. 10 crore of that will flow into PBT?

Patanjali Keswani: Yes, maybe Rs. 11 crore actually.

Aadesh Mehta: Okay so basically the cost of running this management contracting business is only around Rs. 2 crore and it is already profitable right now?

Patanjali Keswani: No, it is not Rs. 2 crore; it is Rs. 2 crore plus at least 50 white hairs on my head every quarter. That is high cost.

Aadesh Mehta: Okay. And sir we heard from you that which geographies are doing very good, if you can highlight which geographies are not doing good for you in terms of occupancy and pricing?

Patanjali Keswani: Well the geographies I am not happy with currently are Ahmadabad, Jaipur, Alleppey, Bandhavgarh, Srinagar, Corbett. So there are certain geographies which are not good. You see what is concerning me in India; I was personally very bullish on leisure. I went to Bangkok and Hua Hin Thailand about two months ago and I discovered that it was full of Indians. So I investigated and I found out that the cost of an air ticket to Bangkok plus the cost of hotel stay for three to four nights for a couple is 20% less than Goa for a much better product.

So I am a little concerned because we are so dependent on the rate of air, the cost of air travel in India that unless that comes down, we are going to be as a country severely affected for domestic tourism vis-à-vis our neighbors. In fact that is why I was asked this question earlier. We have decided to put up hotels in Thimphu, and Dubai, in Kathmandu now we look at Sri Lanka. We will also look at Bangkok all these on an asset light basis because these are our customers also.

You know one in 20 rooms in India are currently with Lemon Tree and in another three years it will be 1 in 13 rooms in India. So these customers I want to capture in India. So we are also considering how to make drivable distance opportunities available so we do not depend on air traffic and in say around Bangalore, Bombay, Delhi and Hyderabad can we create resorts in a relatively asset light way to capture to give opportunities to Indians to travel easily at low cost within India. Suppose we are then dependent on roads but I think roads are doing very well in India.

Aadesh Mehta: Yes. And in terms of your rental housing business what kind of PBT you would be expecting per room?



Patanjali Keswani: So let me split it into two parts, one is the pure rental side, then one is the add on facilities that you give and the PBT you achieve there. Now that is fluid. We do not know what to include, what not to. For example for students we have to give food but for co-living professionals we intend to tie up with Swiggy and with Zomato and so on and get a discount for our customers and we will only provide breakfast.

So if that is the case and I look at pure rental, the flow through operating leverage is about 90% because you bill everything. You bill for electricity, you bill for water, you meter it so the only cost is some level of fixed cost towards security officers, staffing and so on and staffing is very, very lean. We are talking of literally one staff for every 100 beds.

Any service you want after that you pay for it and we will create a high technology platform whether it is for customer convenience or for customer outreach and distribution. So this incidentally will have benefits for Lemon Tree going forward but that is in the future. So operating leverage 90% for pure rental, for the rest I am not sure. We are still costing it but we reckon that it will be a cost plus 20% basis that we will operate on.

Moderator: Thank you. The next question is from the line of Zaharah Sheriff from Fedwinteg Knowledge. Please go ahead.

Zaharah Sheriff: I just want to know in the light of all the optimism that we have in the business and regardless also of that, what are some of the top things that you worry about like two or three things that you keep you awake?

Patanjali Keswani: The three things that keep me awake. First is investor calls. Second is I think our industry has been traditionally under analyzed and I really want to work with all of you and explain our perspective and for you to understand that it is actually a very, very exciting business and the last 10 years are no indicator of future performance and I think the next 10 years will blow all investors the way how this business will do in India.

So the things that really worry me are first and foremost actually people ask me what are you do as the CEO, I will say I focus on people, risk and reputation. So people talent so I want to go to non-traditional talent pools, I do not want to compete with the traditional branded hotels for high priced resources, I want to see social impact so I spent a lot of time trying to reach out to non-traditional talent pools to make them inclusive in our system. Now our employee strength is going to double in the next four years.

So we would like to see 40% to 45% of our employees coming who are not employable and reaching out to them, training them is a very exciting and also a part of my job which keeps me awake. Second is risk. There are three types of risk I look at. Risks I can mitigate completely, risk I can part mitigate and risk I cannot mitigate.

So if there is a coalition government it is not good for the economy or whatever, is something I do not consider. What I look at is very simple. Any business I look at that we are doing I build a margin of safety of 20% and that is the limit of data I like to take. So debt to me is the first risk I mitigate.

The second risk I want to mitigate is linked to disruption. So technology for me is a very exciting space. My plan is that with Hamstede which is our co-living joint venture I have talked to Warburg Pincus and said let us create a shared services



platform between Hamstede and Lemon Tree at an arm's length since the investors are different and let us focus specifically on three aspects which is technology as a disruptor for our system and the four ways I am looking at technology is how do I improve customer outreach, how do I improve customer convenience, how do I improve operational efficiency and how do I improve my own internal MIS on a real time basis.

Again I want to convert and use this technology for our loyalty program. So we have now a little over 900,000 members. Keep in mind that Jet Airways 8 million members are valued at \$0.5 billion. We expect that in 2.5 years our loyalty program will have in excess of 4 million members.

So we are adding 25,000 to 30,000 a month and we think that will go up to 50,000 to 60,000 a month in another 6 months to 9 months. So how do we offer technology combine technology and customer loyalty and how does this play out is what we are looking at. So we are going to create technology company really which will be co-owned by Lemon Tree and Hamstede.

The third risk I worry about is of course attrition of people key talent for my system because if you look at it from an entrepreneur's lens what is entrepreneurship, it is three things. The business model which we have to constantly tweak to be relevant. It is the capital at your disposal and it is the talent to execute your vision and deploy the capital. Today if there is a problem I have in our system because we are growing so fast is the creation of enough talent.

So that is another thing that keeps me awake. Otherwise I generally sleep like a baby.

Zaharah Sheriff:

I just had two follow-on questions to that. I have been actually tracking the industry for a little longer than the last 10 years. So I remember what happened in 2007. The two things that normally which been happened when the cycle turns and things start becoming great is that the attrition like you said goes up because just comparable options for employees are available because the economy also is normally doing well.

And the second thing is that when you are like reach in cash flows then typical capital allocation mistake happen and every time every cycle it is a new capital allocation mistake but they tend to happen. So just wondering if I know it is a very far out in the future but just if looking at it from a long term perspective do you have any account to share on that as well?

Patanjali Keswani:

Yeah, so as I told you one of the key risks that I want to mitigate is debt. So I have a very simple plan. My plan is that pay off debt. So at that I have a counter cycle view which means that the bottom of cycle when everybody is distressed I would look at buying assets where I feel with our operational capabilities and the strength of our brand in distribution we will be able to turn them around. So to me that is an opportunity which initially I expect markets may not reward me for but from a three year perspective I expect outside returns on those deals.

So here is my thought process. I am still in the market to acquire very distressed assets. At the top of the cycle and this is a commitment I will make to every investor of Lemon Tree including myself, I will sell as far as possible every single asset that we have. I want no asset, see asset returns from me are a 7% business. Development return for Lemon Tree whenever we develop assets and put them in



joint ventures like with APG our return has been 40% ROCEs per annum for over three years

In terms of management we expect are ROCE on capital deployed is anywhere from 25% to 40% and in brand ROCE returns once the brand is strong and recognizable is over 100%. So clearly, I want to get out of the asset ownership business. What we will do with that cash well, obviously we will find the most tax effective way to return it to shareholders in the next five years.

So I want an asset light balance sheet, I want higher ROCEs on brand, on development so we will do development partnerships and capture that upside and we want to manage. That is it. So if you ask me for a simple long term view I want not a single asset including my car on the balance sheet.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.

Patanjali Keswani: Thank you everybody. Thank you for the questions. They made me think a bit and I look forward to talking to you folks again after three months.

Moderator: Thank you. Ladies and gentlemen, on behalf of Lemon Tree Hotels that concludes today's conference. Thank you for joining us and you may now disconnect your lines.

-End-

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