



Lemon Tree Hotels Limited

Q1 FY19 Earnings Conference Call

August 16, 2018

Moderator Ladies and gentlemen, good day and welcome to the Lemon Tree Hotels Earnings Conference Call. As a reminder, all participant 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 '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Varun Divadkar from CDR India. Thank you and over to you, sir.

Varun Divadkar Thanks. Good afternoon, everyone. Thank you for joining us on the Q1 FY19 Earnings Conference Call of Lemon Tree Hotels Ltd. We have with us today Mr. Patanjali Keswani – Chairman and Managing Director, and Mr. Kapil Sharma – Chief Financial Officer of the company.

Before we begin, I would like to state that some of the statements in today's call may be forward-looking in nature. A detailed statement in this regard is available on the results presentation that has been sent to you earlier.

I now invite Mr. Keswani to make his opening remarks. Thank you.

Patanjali Keswani Thank you. Good afternoon, everybody. Thank you for joining the call. I hope all of you have had an opportunity to go through our Results Presentation which provides details of our operational / financial performance for Q1 FY19.

We made a strong start to the year. It is actually traditionally a very off season quarter in which we have delivered a top-line growth of about 18% to about Rs. 128 crore compared to Rs. 108.5 crore in the previous year. Now, Q1 and Q2 are seasonally soft quarters for the business and the performance really picks up in Q3 and Q4. So, given the seasonality, the hotel business is best monitored on a year-on-year basis.

Our focus and operational excellence continue. Our EBITDA improved by 30% year-on-year to Rs. 35 crore in Q1 compared to Rs. 26.9 crore in Q1 FY18. EBITDA margins also expanded by 250 bps to 27.3% in Q1 FY19 as compared to 24.8% in Q1 FY18.

EBITDA margins for the same hotels expanded actually by 320 bps to 28% and for better understanding the seasonality in the business please refer to Slide #14 in the results presentation where we have provided a quarterly contribution of revenue and EBITDA to full year performance based on FY18 numbers. So, in



terms of revenue Q1, Q2, Q3 and Q4 contribute 22%, 23%, 27% and 28% respectively to the full year revenue for same hotels in FY18. So, really H1 is 45% and H2 is 55%. In terms of EBITDA Q1, Q2, Q3 and Q4 contribute 19%, 20%, 30% and 31% respectively to the full year EBITDA for same hotels. Part of the reason is obviously that the revenue goes up in H2 but the costs are more or less similar, which is why EBITDA contribution in H1 is 39%, although the revenue contribution is 45%.

Profit after tax for Q1 FY19 stood at Rs. 22 million as compared to a loss of Rs. 31 million in Q1 FY18. Cash profit, which is the key metric for us, which is PAT plus depreciation grew by 41% year-on-year to Rs. 154 million in Q1 this year compared to Rs. 109 million in Q1 FY18.

Average daily rate increased by 15% year-on-year to Rs. 3,899 in Q1 this year as compared to Rs. 3,376 in Q1 last year, and this was driven by price hike which we undertook in H2 FY18. We now expect far more significant price hikes in the next three to five years.

We continue to also retain our occupancy premium. Occupancy increased by 250 bps to 76.8% in Q1 FY19 as compared to 74.3% in Q1 FY18. Therefore, RevPAR growth has been quite robust at 19% year-on-year in Q1 FY9.

Our current operational inventory comprises of 4,998 rooms of which 3,277 are owned / leased; and 1,721 are managed. As of June 2018, the active development pipeline of 3,238 rooms comprises of 1,525 owned / leased rooms and 1,713 rooms under management contract. Of these close to 1,600 rooms will be operational by end of Q1 FY20. The remaining rooms will be operationalized by the end of FY21.

The project cost of the current pipeline is roughly Rs. 17.25 billion, of this Rs. 9.3 billion has already been deployed by the end of this past quarter. The balance investment of about Rs. 7.9 billion will be mainly funded through internal accruals and deployed in a phased manner over the next three years. We expect debt levels to peak by end of this year and then come down.

We are happy to share another key development. We have received the requisite pre-construction approvals for Lemon Tree Premier Mumbai International Airport, and of course construction has commenced. We are now evaluating conversion of some of the commercial space in this hotel to room which will increase the hotel's inventory by 94 rooms to 671 rooms. We expect this hotel to be operational by calendar 2021 and it will be by inventory the largest hotel in India across all segments in the best most demand dense and highest ARR market.

We are now in a strong position with a large inventory of hotels moving towards steady state opened in the last three years resulting in significant operational leverage. Given the large demand / supply mismatch which exists now in the mid-price hotel sector, as I have said, we expect the trend in price hikes to continue over the next three to five years and this should lead to significant RevPAR growth and of course play out of operating leverage.

Further, we also have a very large planned supply of high value inventory as I said, in demand dense regions of Mumbai, Pune and Udaipur which will be operationalized in the next few quarters. This coupled with an expected price

increase nationally and our operational cost competitiveness should drive strong cash flows in the coming years.

Going forward we want to go asset light and monetize our brand / management competencies, so the majority of new supply addition will be on the leased and management side. Post March 2018 we have already added another 570 rooms to our pipeline of management contracts. In July 2018 we have also operationalized the managed hotels with 111 rooms under the Red Fox brand in Morjim Goa.

We also intend to use our asset monetization strategy in the future to generate further capital in order to fund both organic and inorganic growth opportunities and expand our owned hotels portfolio without investing more cash from our balance sheet, unless of course a very compelling opportunity arises. We are now well positioned to capitalize on the strong industry dynamics with increasing occupancy levels and ADR on the back of our leadership position in the mid-priced hotel sector, our end-to-end capabilities, our pan-India geographical presence at convenient locations, our quality service, diversified brand portfolio, value-for-money proposition and low-cost structures.

So, 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 Q&A.

Moderator

Thank you very much. Ladies & gentlemen we will now begin the question-and-answer session. We have the first question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal

My question on this management fee number which we have reported in the slide #12 of this quarterly presentation at Rs. 4.78 crore whereas in the annual report the full year number is Rs. 6.4 crore. On the last concall you commented that Rs. 18 crore is the total fee income coming from Carnation and Fleur and that will be going to Rs. 32 crore this year. The numbers are not matching, can you help me to understand these two numbers.

Patanjali Keswani

So, while we pull out the figures, broadly let me explain how management fees come into Lemon Tree. There are two companies, one is Fleur Hotels where we are close to 60% shareholders. So, we get three levels of fees from them, one is pure management fees, one is allocation towards corporate office expenses and one is sales and marketing fees. Carnation being a 75% subsidiary, keeps about 60% or 65% of the fees which are really management fees, and the sales and marketing and loyalty program fees come directly to Lemon Tree.

Kapil Sharma

Manish, when you look at the revenues from operations schedule in the annual report, there are actually two figures which you need to add to get to the real number. So, I think you are looking at other operating revenue which is showing management fee of Rs. 637 lakhs, but the other part is included in the line item just above that which is other services including service charge income, which is a figure of Rs. 49.46 crore. So, out of this if you refer to page #38, if you have the annual report, there is an income note on the bottom two line you will find that we have written that company's management fee income from the managed hotel increased by 127% from Rs. 620 lakh for fiscal 2017 to Rs. 1,410 lakh for fiscal 2018, this was Rs. 14 crore. So, you are getting mismatched because of this breakup actually, the presentation had two heads actually, otherwise there is no difference.

Patanjali Keswani So, the fee income broadly that we get is three levels across two companies, one if the management and incentive fees, one is the sales and marketing fees, then from Fleur we also get allocation of corporate office expenses some fees and lastly is Lemon Tree Smiles which is our loyalty program which is billed to the pure managed hotels portfolio. So, you really have to add up these four.

Manish Ostwal Sure. Second question again your comment on the debt peak out and last time also you commented that the company will be debt free in next five years. And sir when you made this comment are you factoring any cash flow coming from the APG structure also?

Patanjali Keswani No, this is purely on how we expect cash flows to play out in the next five years. And the only assumption we have made is that we will not deploy further capital.

Manish Ostwal And last small data point, what was the total CAPEX during the quarter and the gross debt number?

Kapil Sharma So, the gross debt number as of 30th June 2018 debt level is Rs. 1,061 crore which was Rs. 1,011 crore at the end of last fiscal, so it increased by Rs. 50 crore.

Patanjali Keswani So, actually the withdrawal is Rs. 61 crore and there is a repayment of around Rs. 10 crore.

Manish Ostwal And the CAPEX in various hotels during the quarter?

Patanjali Keswani You are talking about new hotels?

Manish Ostwal Yes, new hotels total CAPEX, we are spending money on building new hotels, right?

Patanjali Keswani Yes.

Kapil Sharma So, are you talking about CWIP projection as of 30th June?

Manish Ostwal Yes.

Kapil Sharma So, as of 30th June the CWIP which stands at Rs. 655 crore, now going forward for another nine months another Rs. 200 crore will be added for operationalizing the projects which are under construction. And at the end after this capitalization, because two capitalizations are going to happen in this financial year which is Mumbai and Pune, so at the end of the year the CWIP remaining would be Rs. 467 crore or Rs. 470 crore.

Manish Ostwal Can you repeat again the current June quarter numbers, Rs. 650 crore?

Kapil Sharma Rs. 655 crore is as of June, additional would be Rs. 200 crore.

Moderator Thank you. We have the next question from the line of Keyur Shah from Emkay Global. Please go ahead.

Keyur Shah Sir, if you can give some insight on how the overall various markets in the country have been performing? And some light on ARR or occupancy growth in various markets where by tier-I or tier-II cities or different states?

Patanjali Keswani So, very broadly, right now what we are seeing is a change in industry dynamics which is playing out at different rates in different micro-markets. So, really the ability to re-price significantly across when the occupancy in the micro market crosses 70%, so I am going to talk to you from that perspective. Now, for the last roughly nine years India has on an average been under 60% occupancy, which means there was an inability to re-price. Now, finally when supply is being absorbed in some micro-markets and this supply absorption where occupancy crosses 70% will happen at different dates and different times in different markets. So, let us come to some specific markets. The markets which are showing signs of significant change in terms of demand dynamics is for example where I am sitting right now which is the Delhi Aero City market where we have 500 rooms. Another market which is showing significant improvement is in Bengaluru which is city center near MG Road where we have a Lemon Tree Premier, and in Electronic City which is near Hosur and in Whitefield. So, in these markets in Bengaluru where we have about 500 rooms there is an improvement in demand where you can see the likelihood of significant price hikes happening going forward. Now if you look at Ahmedabad, another market that has remained very flat because supply is still being absorbed and my best guess is it will take another two years to be absorbed. So, broadly, if you look market by market there are different symptoms. What you can be very sure about is that by FY20, latest FY21 nearly every major market in India will have price hikes. My best guess is that the first ones that will go through it will be Delhi, Bengaluru, Mumbai, Gurgaon and perhaps a year later Hyderabad, markets that will lag will be Chennai and Kolkata should absorb the supply by the time we open our hotel. Pune will do very well, my expectation is Pune will show a huge hike in price in the next 18 months.

Keyur Shah And Kolkata, what did you say you would see the hike?

Patanjali Keswani Very difficult for me to estimate, but as I said, in the next two years you will see hikes across each market which will be significant. So, whether it happens in calendar 2020 or 2021 I really cannot tell.

Keyur Shah But is it fair to say that Kolkata is the slowest growing market?

Patanjali Keswani No, Ahmedabad, Jaipur is the slowest growing market, Chennai has been working through massive supply addition, so Chennai in my opinion will take two years, maybe even three years. Indore is a slow market, but broadly where we have large inventories this has been a question that was asked of me even by investors during the IPO road shows, we have consciously deployed capital only in markets which are demand dense, so while they may go through supply overhangs, we are absorbed the fastest. And therefore, in terms of ROCs they ultimately generate the higher return on capital.

Moderator Thank you. We have the next question from the line of Himanshu Shah from HDFC Securities Please go ahead.

Himanshu Shah Sir, on slide #21 our online hotel bookings leads to high yield, so these online bookings are on our own websites where the contribution has gone up from 16% to 19%?

Patanjali Keswani No. So, online is, as you must be aware, globally a phenomenon which is being led by online travel agencies like Expedia, Booking.com or Priceline, in India there is MakeMyTrip and so on. So, about 25% of all our bookings is online and of that about 75-77% are through online travel agents and the balance is through our own



Lemontreehotels.com website. Now, as far as economics go, typically online booking on an aggregate generate highest yields, and I mean even after OTA's commissions. So, obviously, bookings that we get on lemontreehotels.com are the very highest, after which if you take out a 15% commission to travel agents who are online travel agents, the next highest yields is online travel agents. But direct bookings on our website or to our call centers give the highest yields. So, we have actually a spectrum of yield, highest is our own website, lowest is of course very large corporates.

Himanshu Shah

Second question is about our loyalty program, so how does it work basically, how does it benefit the company and the customer? We have around 8 lakh plus members, so just if you can provide some color on that?

Patanjali Keswani

So, you see it is still interestingly globally subject to questioning that what drives loyalty programs and what drives customers to use loyalty programs. So, simply it is a question of return to the person. So, loyalty programs are driven by the following principle which is you come in, if you use me enough come and join me, join my program and I will give you benefits which overtime will play out in one of three ways, either in terms of free rooms; or in room upgrades or in terms of cash back which is a program which others do, we do not give cash back; and the third is you get also get gift vouchers of equivalent so that you can acquire white goods or fashion goods and so on and so forth. Our loyalty program is fundamentally premised on the following which is we would love to give you free room nights and freebies in our hotels because the cost of that is the lowest possible. The next cost is of course if you take a voucher then our cost is actually the discount that we get from that provider of goods. So, it is a more expensive proposition for us. So, we try and offer in terms of perceived value a much higher benefit if you use hotel services. So, if I spoke off-the-cuff, I would reckon about 90% of our loyalty program costs are delivered actually through hotel services itself which is actually not a material cost in our system. If you look at consumption of who uses loyalty programs, it is obviously frequent travelers, Indians love freebies by the way, in fact, they want everything for free if possible. What we find is that the guys who use our loyalty program are actually very similar to the people who shop online, who travel by air and this is a very small population in India whose personal consumption expenditure covers these three. And I would reckon that the entire size of the market may be 10 to 20 million households, or less than 100 million people. So, we are very pleased with the fact that maybe 3% to 5% of the household that consume are already members of our loyalty programs, which means less than three years old. What we are seeing happening interestingly is that every single managed hotel that we have started in the last two years, over 10% of the demand has been a member of our loyalty program. So, we have now this ability to generate incremental demand in new markets for our asset owners and this only helps us become more competitive, both when we open new hotels and of course when we manage other people's hotels. So, it is a fly wheel basically.

Himanshu Shah

Sir, in our annual report there is a line item on un-amortized portion of security deposits and loans worth ~Rs. 190 crore in non-current asset. So, what exactly is this line item, basically unamortized portion means?

Kapil Sharma

Separately just tell us which page what you are referring to.

Himanshu Shah

Sure, I will just write back or will get in touch with you. Sir, just one last question, now you did mention about this specific micro markets where you would see, but somehow does this hold true across category, means like Delhi, Gurgaon probably



accounts for one-third of our own properties and we are seeing very strong traction over there. So, if you can just provide some color on competitive intensity in that market? And other segments like five star and luxury segment, would they also be seeing similar kind of occupancy and ARR growth? Because some of our larger competitors, we are not seeing this kind of performance at their level in terms of either occupancy and therefore ARR.

Patanjali Keswani

Himanshu, that is actually not quite correct because, firstly, we do not have such a large inventory in Gurgaon, I think we only own about 500 rooms in Gurgaon, which is about 15% - 16% of our total inventory. But coming to your point, I will give you a simple example to give you color of two things, how luxury hotels and budget hotels move in-sync in different parts of the cycle and how prices go up. So, I am giving you actual numbers. When we opened our first hotel ever which was in Gurgaon in Udyog Vihar in 2004, it was just starting to become top-up cycle like I see today after another 14 years. So, in 2004 Lemon Tree Udyog Vihar opened at Rs. 2,000 average rate, and the Trident Gurgaon which had just opened, opened at Rs. 5,000. In 2004 our occupancy was 65%. In 2008 Lemon Tree's average rate was Rs. 9,000, it had grown 4.5 times and the occupancy was 90%. The Trident Gurgaon in 2008, its price grew from Rs. 5,000 to Rs. 25,000 and its occupancy was also 90%. So, in four years the price grew 5x and occupancies went 1.5x. Nine years later, in 2017, Udyog Vihar's price was Rs. 3,600 at an 80% plus occupancy, which means it had dropped by 60%, Trident had dropped to Rs. 11,000, it had dropped by 50% and it was also doing 80% occupancy. So, that should give you an exact idea, they move in-sync, they both go up, but different customers and obviously different price points.

Moderator

Thank you. We have the next question from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta

Sir, just wanted to check, adjusting for our customer acquisition costs, which is OTA commissions, what kind of organic price hikes are we actually seeing? I understand the ADR growth has been 15% YoY.

Patanjali Keswani

No, see price hike is across segments, so if you look at our price hike for large corporate or small, medium and micro corporate or for direct bookings whether through online travel agents or through website or those who call our hotel call centers and directly make bookings, the weighted average of same hotels has been actually 14%. What we are reporting in this report is the blended average for the whole company which was 15% but same hotels was 14%. OTA commissions would obviously be a part of it, so let me just pull out the appropriate figures. So, for example, OTA bookings and the cost of that went up by Rs. 1 crore in Q1 FY18, OTA revenue went up by 27%. So this had a positive impact on revenue and obviously on cost, because obviously OTA bookings lead to improved ARR. To answer your question, even the net ARR that we get from OTA bookings which is direct are at a higher rate than our average rate, which is why it helps drive up ARR for average room rate.

Aadesh Mehta

And how much of this 14% increase we are seeing could be because of mix change from corporate to retail?

Patanjali Keswani

A significant amount, you see our ability to re-price with very large accounts is obviously more limited than with an individual customer who is booking on our website or through an OTA. So, the correct question is, actually, how did we do when we were sold out? Because the real re-pricing happens in our business when there is a daily demand imbalance between supply and demand. So, it is like the

airline sector. So, if demand picks up and it is obviously in business hotels it is driven more Monday to Thursday, and 40% of our customers on those days are late bookings, they will obviously pay you a high price. And that helps you to drive your ARR up. Now, I have not done a broad waterfall of how is the breakdown of this 14%, but your assumption is not incorrect, more than 50% of this price hike is driven by non-corporate demand.

Moderator

Thank you. We have the next question from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.

Kaustubh Pawaskar

Sir, your margins remained almost stable in FY2018 at about 29% and this quarter we have seen 250 bps improvement in margins, despite the fact that it is a lean quarter for the business. So, what will be your margin expectation for FY2019 and FY2020? Since RevPAR is increasing, should we expect 150 bps to 200 bps margins for you for FY2019 and 2020?

Patanjali Keswani

Broadly, so let me explain. In Q1 this year actually, same hotels margin expansion was 320 bps, so it went from 24.8% in Q1 FY18 to 28% in Q1 FY19. So, what you are seeing which is the EBITDA margin expansion of 250 bps has come down because three hotels of ours are new and still getting stable, which is two hotels in Sector 16, Gurgaon, which is 250 odd rooms, and an 85-room hotel in Banjara Hills that we have taken on long lease, which we opened in March this year. So, these have had a slowdown impact on our margin expansion, and therefore the expansion is only 250 bps on a blended basis. See, what has happened, let me explain operating leverage flow-through to you because I think that is the underlying question you have. If you look at these three hotels of ours, they accounted for roughly 5% of our inventory which is Lemon Tree and Red Fox in Sector 16, Gurgaon, and Banjara Hills Lemon Tree. Now, if you look at the growth in revenue of these three hotels, because two of these were very new and opened in Q1 of last year and one opened in Q4 of last year, the revenue growth in this quarter versus the last quarter had been Rs. 6 crore between these three hotels. So, when you see a revenue growth of Rs. 20 crore, Rs. 6 crore is these new hotels. What we try and do when we open new hotels is, because there is a very high fixed cost component, in order to avoid very large negative EBITDAs which are a drag, we also staff them at a much lower level and as the hotel starts picking traction we start increasing staffing. So, the net impact of this growth in revenue of these three hotels on an EBITDA basis has been close to zero. So, when I say our revenue has grown by Rs. 19.5 crore actually Rs. 6 crore of that revenue has not impacted our EBITDA, it will start impacting our EBITDA now that they have broken even. So, going forward they will be EBITDA positive and will quite quickly move towards this 30% EBITDA level. So, really the EBITDA growth that you see of Lemon Tree which is about Rs. 8 crore from last year to this year has been driven because of a Rs. 13-odd crore increase in revenue, because that other Rs. 6 crore has not had any impact on EBITDA for this quarter. But going forward what is interesting is, already Banjara Hills in July has become EBITDA positive significantly, so it has stabilized. So, this is an ongoing journey, every time we open a hotel, especially a large hotel where lease rentals are high, it takes us anywhere from three months to 18 months to stabilize that hotel, depending on that market.

Kaustubh Pawaskar

But at the sustainable level, I can understand that this is about the operating leverage and operating parameters we have been talking, but at the sustainable level we have seen that you have three categories of hotels in your portfolio and there is a premium hotel as well. If the mix shifts towards the premium hotel, should we expect that also to add on to your margins going ahead?

Patanjali Keswani Margins as a percentage of revenue are kind of similar, irrespective of whether it is a Lemon Tree Premium, or Lemon Tree or a Red Fox. That means it is kind of similar whether it is a 4-star, 3-star or a 2-star. In fact, in our 2-star hotel category the margins are actually higher when they stabilize, but of course the revenues are much lower. To your broad question, will margins expand, so here is my, and it is a little forward my statement, H1 of this year is whether it is Q2 or Q1 it will be somewhat similar, because broadly if you look at our cost structure, while 45% of our revenues come from H1, 47% to 48% of our expenses come from H1. So, in EBITDA terms it is less than 40% of the full year. So, consequently, you are right that on an annual basis H2 contribution towards EBITDA is much, much larger, it is 1.5 times what it is in H1, in fact more than 1.5 times. So, our broad expectation is that our EBITDA margins this year and you will ask me this, I have no doubt after end of the year, should be 33-35%, on a weighted average basis.

Moderator Thank you. We have the next question from the line of Ansuman Deb from ICICI Securities. Please go ahead.

Ansuman Deb I just wanted to reconcile the EBITDA per room that you have shared. So, if I look at the EBITDA per room that you have shared for LT Premier, LT and Red Fox, what is the number at the consolidated level which we should look? I know the notes mention as EBITDA plus rental, if you could help me understand how do consolidate that?

Patanjali Keswani Actually I have not understood the question, so let me explain the parameter. How we track our company performance is we look at hotel level EBITDAR because that is the return we are getting purely from the asset, at the asset level. Then after that we deduct lease rentals and we deduct interest, because these are the two costs that are incurred towards that asset. So, in our minds we treat lease rental as an equivalent of interest, because we have borrowed that asset for 30-40 year period. After that we remove two other expenses which are corporate office expenses and obviously depreciation, which is a non-cash expense. And that is how we derive PBT. So, what is our forward plan, our long-term plan is very simple that by growing the management room business significantly which we are well on track for, our corporate office expenses will be entirely defrayed by the management fee income that we bill to the hotels that we manage. Therefore, how I see it playing out in the next three years is very simple, we expect hotel level EBITDAR margins to pick up significantly with price hikes and operating leveraging coming in. The only two costs that we will really incur, one is the cash cost which is the lease rentals which over time because our average annual escalation of lease rental sticks at less than 3% and with price hikes obviously being north of that, as a percentage of revenue lease rentals will keep dropping. And of course, depreciation will kick in as and when we open new hotels, but depreciation, as I mentioned, is just a tax benefit for us. So, long-term what we hope to see is 95% of our hotel level EBITDAR flows straight through to PBT and then to PAT.

Kaustub Pawaskar I was asking, you have mentioned in your slide about the EBITDAR per room in LT Premier, LT, and Red Fox. So, if I multiply that EBITDAR per room with the rooms that you have in those respective hotels, that should give me the overall consolidated EBITDAR but adjusted for some of the corporate expenses which will not be there in these individual hotels?

Patanjali Keswani That is correct.

Kaustub Pawaskar So, it would have a difference, it will not be exactly similar?

Patanjali Keswani Absolutely. So, you take our inventory of Lemon Tree Premier and multiply it by EBITDAR per room, and similarly for the other two brands, it will give you the consolidated EBITDAR of the company, after which we have to adjust for lease rental, interest, depreciation, corporate expenses to come to PBT.

Kaustub Pawaskar And last question from my side, your standalone EBITDA margin is higher than your consolidated, if you could give a color on the differential between the two because the new hotels are in the subsidiary?

Patanjali Keswani That is broadly correct. It could also be because of micro-market, frankly, but it is mostly because the new inventory is coming up in our subsidiary, except for Mumbai. So, Mumbai which we will open in the next six months or less will be in Lemon Tree Hotels. But Pune, now we will be opening in one-month, Dehradun and later Udaipur and Kolkata, all these hotels will be in the new company. So, they will have a drag on EBITDAR per room till they stabilize.

Moderator Thank you. We have the next question from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta Just a data keeping question, what could be the OTA commissions this quarter and this corresponding quarter of last year?

Patanjali Keswani See, how it works is OTA business is a little like Google business. So, there is something called search engine optimization and so on and so forth, so we find typically unless a customer is very brand loyal he normally selects what is on the first page of an OTA website, when he types in give me a mid-market hotel in Gurgaon. So, an online travel agent like example MakeMyTrip, we are still of course not giving cash backs, but typically when we need help, example in Jaipur where the market is not strong, so how MakeMyTrip helps is they give cash back when a customer books on their website and take just a little bit for that. So, on an overall basis our commissions, it is called an over-ride, and our commissions typically are about 15% of the rate. And in those specific markets where we want higher visibility because demand is low, we typically pay an additional commission of about 3%. So, on a blended basis our OTA commissions would be say 16% perhaps of the bookings on the channel.

Aadesh Mehta They should be 16% of the retail bookings?

Patanjali Keswani That is right.

Aadesh Mehta If I were to see the absolute number, how would that look for this quarter?

Patanjali Keswani So, this quarter we got about Rs. 21.5 crore of revenue from OTAs and the total commission was Rs. 3.5 crore.

Aadesh Mehta And this Rs. 3.5 crore was Rs. 2.5 crore last year same quarter?

Patanjali Keswani Yes.

Aadesh Mehta And the other thing I wanted to ask, in the Red Fox segment we are seeing a drastic improvement in occupancy, any comments on that?

- Patanjali Keswani** Because we opened Red Fox Sector 60 which is a Rs. 154 room hotel in our subsidiary which is Fleur Hotels we opened it in May last year. So, in the first two months it had hardly any occupancy in Q1 last year.
- Moderator** Thank you. We have the next question from the line of Niraj Mansingka from Goldman Sachs. Please go ahead.
- Niraj Mansingka** Just wanted to ask a question on the corporate versus retail, we have seen your average prices going up. Can you comment on how the RFPs of various corporate had been and how much industry has seen a demand recently, growth rate in the RFP prices? And how much is the difference between the retail and corporate pricing?
- Patanjali Keswani** So, broadly, and I am speaking very broadly, it works like this, this question has been off me by many investors and analyst, so I will explain it very broadly. Large corporates because they have demands across multiple cities in large volumes and have their own procurement departments which are focused entirely on negotiating with players like hotels and airlines, they have an ability to get a very good price. Small, medium and micro enterprises which typically require rooms in maybe two or three cities and not large volumes do not have an ability to negotiate strongly. Direct bookings through online travel agents or through our website or through our call centers, pick-up rooms based on spot pricing and spot pricing is a function only of very localized micro-market demand supply dynamics and how your competitive hotels price themselves versus you in that market on that day. So, that is like airline pricing. If you look at us four years back, 50% of Lemon Tree's demand was large corporates, about 35% was small, medium, micro and only 15% was online / direct. If you look at pricing, and I am speaking very broadly, the average pricing of a large corporate was 80% of my ARR, of a small, medium, micro corporate was 100% of my ARR, and that 15% which was direct was paying me net-net, 120% of my ARR. So, if you average these three my average pricing would then be say 93. In the last four years we have made it a deliberate attempt for two reasons, one is, we have seen a very strong aspirational shift by the average Indian middle-class consumer who is typically under 40 years of age and has increasing disposable income. These customers years ago used to stay mostly with friends and family or an unbranded small, standalone hotels or guest houses. Now they have aspirationally shifted clearly towards branded mid-market hotels. So, we have been able to drive this aspirational shift demand in to our hotels. So, today, very broadly, instead of 50%, 33% of our customers are front large corporates, the small, medium, micro enterprises corporate are roughly 33% and the online and direct customers are also 33%. So, that is how our ARR, part of the reason our ARR went up because the consumers at higher ends have started shifting towards using branded mid-market hotels. Does that answer your question?
- Niraj Mansingka** Partially. Just wanted to understand that whatever you said the pricing of 80% of ARR for large corporates, 100% for SMEs and 120% direct, what is the difference right now and what was the difference a year back?
- Patanjali Keswani** It would be depending on which account, it would be anyway from 3% to 10%.
- Niraj Mansingka** I did not get that, it was 80%....
- Patanjali Keswani** Depending on the micro market it would be anywhere from 3% to 10%.

Niraj Mansingka What I was asking, if your average ARR is 100% and it was 80% four years back for a large corporate, how is it different right now?

Patanjali Keswani See, typically a large corporate will give you an increase anywhere depending on which city they need you at, they will give you a price hike from 3% to up to 10% year-by-year. But in a bad year they will give you 0% to 5%.

Niraj Mansingka Got it. Just a small follow-up, has the differential increased between a direct versus corporate in the last six months?

Patanjali Keswani Yes, absolutely.

Niraj Mansingka So, do you see the difference in percentage narrowing and when do you see that happening?

Patanjali Keswani See, what happens is that it is your marketing and sales strategy that when you see demand in high yield segments pick up you do what is called an allocation. So, suppose I have a hotel with 200 rooms and normally my demand is 100 goes to large corporates and 100 goes to the others. But when I see demand picking up of high yield we do what is called allocation-based supply. So, we reduce the amount of rooms we offer to large corporates directly linked to the demand increase in the higher yield segments. So, to answer your question, my view is that large corporates within two years will see massive price hikes by all hotel suppliers across India. So, that is my broad view, otherwise they will not get rooms in hotels.

Moderator Thank you. We have the next question from the line of Deepika Mundra from JP Morgan. Please go ahead.

Deepika Mundra I just wanted to check, you mentioned that about the margin expansion, would you be factoring in any one-off or large expenses for commissioning of the two new properties at the end of the year as well in that guidance?

Patanjali Keswani Well, what we try and do is in our business fixed costs are, as you know, most of the costs are fixed. So, what we try and do is whenever we open a new hotel in our minds we try and estimate demand for the first one year and we proportionately reduce, so let me explain it in a very simplistic way, suppose I open a 300 room hotel in Mumbai which I will do in the next few months, I will staff it as if it is a 100 room hotel. And while I have the whole hotel ready I will keep air conditioning, power and fuel, staffing, everything linked only to say 100 or 120 rooms. When demand picks up to that 100, 120 rooms then I will incrementally keep staffing it and keep increasing my fixed cost. So, I do not expect a big negative impact in Mumbai and Pune because it is a very demand deep market and I expect to be able to stabilize it very quickly like we did Banjara Hills. So, as I said, Banjara Hills in four months has become significantly EBITDA positive. My expectation is, impact of these might reduce my margin expansion by at most 100 to 120 bps. So, when I gave that broad guidance of 33-35%, in my mind I had factored this.

Deepika Mundra And sir lastly, could you give us an update on the Mumbai Airport hotel and the status on that?

Patanjali Keswani So, as you know, we bought this in 2015 from MIAL which is a joint venture between GVK Group and Airport Authority. We are the only people actually I think who have bought a hotel plot there. It is a fairly large plot which is very-very close to the ITC Maratha and the Hyatt, very close to the international airport. It is a very-

very demand dense region, I am told occupancies are well north of 80% in that market. We have acquired 500,000 square feet of FSI and basement of about 300,000 square feet. As I mentioned, we are building India's, by inventory, largest hotel there. We are also putting up a large convention center. So, we will most likely in calendar 2021 open this hotel, we have all requisite approvals. Our construction is on in full swing, in fact it got delayed because of the monsoon, but it is still going on now. And when it opens we think it will be a game changer for our company.

Moderator

Thank you. We have the next question from the line of Prasoan Agarwal from Indus Capital. Please go ahead.

Prasoan Agarwal

Just one question on these managed hotels, if I compare it to the last quarterly release versus now, I see almost a 33% increase in the managed hotel pipeline. So, last quarter that number was 1,340 and now we are talking about 1,775 and around 17 rooms got added in this quarter itself. So, first of all, what is driving this acceleration in managed hotels addition? And secondly, what should be the kind of expectation we could have from the revenue coming from this part? Because obviously during the IPO time this number was low, and I do not think we are building much into the estimates on the managed hotels part right now?

Patanjali Keswani

See, if I give you a number for Q1 this year versus Q1 last year, the revenue growth of hotels that we manage has been about 134%. So, it is obviously accelerating very fast. What we find interesting is after we have gone public I think it has helped give our brand enough visibility with a lot of onus, plus our general performance has been, without sounding immodest, quite good for the owners. And what we find is that this referral among owners and our brand visibility and our outreach to hotels currently being managed by other brands has enabled us to accelerate this. And frankly, the rate of growth is something we see we can sustain over the next three to five years. So, while at the IPO we gave whatever we had, we do see that this is a fly wheel and it will accelerate quite significantly going forward.

Prasoan Agarwal

And it was also on the prospectus and I think you briefly mentioned about the revenue model here, but is there any, so let's say if the occupancy is running higher, is there a variable component attached to it or it is just a percentage of revenue along with the membership points, etc., on the revenue contribution?

Patanjali Keswani

There is a very large variable component, it is called incentive fees. So, typically when we sign a management contract we try to ensure that we get rewarded for performance where there is some pain for us if we do not perform along with the owner, because we thought like owners when we discussed this with the owners. So, really, if we give you an EBITDA margin at the hotel level under say 30%, we will only take 2% of your operating profits as our incentive fees. But this is a sliding scale, and if we take EBITDA margins to say 45% or north of that, then we will take up to 8% or 10% of your operating profit as our incentive fees. So, you are right, we see a double-whammy right now I think we have signed about 3,400 rooms, of which about half are operating and half will come onboard in the next two years. And what will happen is it will be a double whammy because not only will our inventory double, but our fees will also go up significantly per room. So, typically, you get anywhere from one-tenth to one-fifth of the hotel's profit as your management / incentive fees, right now we get about one-seventh of each hotel's profit as our fees. When the things pickup, as we hope they do, then our fees from each hotel will rise to maybe taking one-fifth of the profits of those hotels. But of course, profits for the owners would be much larger.

Prasoon Agarwal And this portion, the pipeline that we have mentioned for now, that is till FY21?

Patanjali Keswani That is correct.

Prasoon Agarwal Same as the operational portfolio?

Patanjali Keswani That is correct.

Prasoon Agarwal And on the revenue contribution, I believe Lemon Tree owns 75% of this pie, or is it 100% ownership?

Patanjali Keswani Well, as far as pure goals which is where we own 60% of the asset company we get 100%. As far as Carnation Hotels goes which manages hotels where we have no equity interest, we get 75% of the management / incentive fees after expenses of Fleur which are quite nominal. We also get directly fees for loyalty program and for sales and marketing. So, typically, for every Rs. 10 of fees that we get from hotels not owned by us, about 65% goes to Carnation and about 35% comes to us directly. And our economic interest in that 65% is 75%. So, very-very broadly for managed hotels our fee income will be between 85% to 87% of the total fees that we charge.

Prasoon Agarwal And the revenue number that we are showing right now, that is this 85% to 87%?

Kapil Sharma Fees from managed hotels, this number will be 100%.

Patanjali Keswani But what you have to keep in mind is that there is a double whammy in this business because we double our inventory of managed hotels, we also expect to nearly double our fees per room. So, the whammy is actually 2x into 2x, it will be 4x.

Moderator Thank you. We have the next question from the line of Shaleen Kumar from UBS. Please go ahead.

Shaleen Kumar This is regarding your earlier comment where basically you are talking about allocation of the rooms between large corporate SMEs and online retail kind of segment. So, if you can share the broad proportion of the room you are selling right now to these three categories? The way you are talking about, the whole industry will start either increasing the price or cutting the room sales to the corporates, so what is going to be your strategy and what kind of a proportion do you see in next two years?

Patanjali Keswani So, let me explain it along three axes. I think what you want to understand how is my price and inventory going to move up and how will my revenue move. First point, my owned inventory will go up by 50% in the next three years, so inventory will go 50% up. Now these hotels the impact of this inventory is mostly in the Lemon Tree Premier segment, because we are opening hotels which are our upscale segment, upper mid-scale segment. So, the revenue impact of this inventory increase will be another 1.5x because as you will notice our Lemon Tree Premier Hotels typically do much higher incomes per room then our other two brands. So, inventory goes up 50%, revenue from this increased inventory goes up 50% which will be, that means this 50% will have a revenue impact of 75%. Third is pricing, we expect that pricing will continue to increase for the next three, going up to six years till fresh supply comes into India. My opinion is, it takes typically four to five years for new supply to come in and nobody is planning new supply at present.



So, even if that takes one or two or three years there will be a further lag of three to five years before that supply gets operationalized. So, there is a runway now broadly of five to seven years in India where no new supply will come up, so supply constraint. Fourth is, demand growth has been 14% every year in India for the last five years. So, demand will continue secularly to grow at 14%, supply will slow down. Fifth, when this happens there will obviously be shortage of rooms, so what do hotels do when there is a shortage of rooms? Quite simply, they increase prices to a level where demand is enough to fill the hotel at the highest possible price, somewhat similar to the airline pricing model. So, what will happen, and this is my forward view on the industry, like I explained to you, earlier the largest consumers of hotel rooms were large corporates, but what is very interesting now is that the fastest growing segment which has now become significant are the customers who are booking directly and are not part of large corporates, in fact they are mostly small, medium, micro enterprises or standalone individuals who are travelling for business or leisure reasons. Their ability to negotiate is far less than large corporate. So, going forward, very simply, their demand will be accommodated before large corporates, unless and until large corporates also increase their prices appropriately.

Shaleen Kumar

Also I was trying to understand, for one of your property let's say, Udyog Vihar property you may be running at 85% kind of occupancy level, just an assumption. Which implies that on a week day you would be running at higher than this and hence limited room for you to increase occupancy. So, what I am trying to understand, how much of the proportion is corporate for you and how much is SME for you in that segment and will you cut down your SME or corporate to increase your spot sales, because there you get the maximum leverage on the price category. And is there a possibility of down trading risk if you increase the price with corporate and SME? I know it is a little theoretical question, but just trying to understand.

Patanjali Keswani

No, it is a very valid question by the way, it is not least theoretical. So, let me give you a better example, let me give you of a market that has already picked up, so let us talk about the hotel where I am sitting which is Lemon Tree Premier, Delhi Airport. When we launched it was I think at Rs. 3,500. We were doing 60% occupancy, it is a 280 rooms hotel. So, initially our largest demand was corporate, in fact it was the Indian Government, one of our largest customers, you will be amused to know, was the Indian Army. The Indian Army used to take 130 to 150 rooms a day from us. Over time what has happened, this demand segment has shifted towards individuals, today the average rate of this hotel is north of Rs. 5,000, EBITDA has over three years tripled, or in fact may have even quadrupled, I am not sure. But the fact is that today 65% of our business is individuals today, which is why the ARR has increased so much. It is not that the corporates have increased their rates, they have hardly increased their rates, what they do is they downtrade there, they go to lower category hotels because there is enough demand at a higher price for our category. So, I am giving you this as a flavor of what is happening. A similar thing has happened in Bengaluru in our LTP, a similar thing has happened in our Lemon Tree Premier in Hyderabad, these are large hotels where you will see significant price hikes because the domestic Indian standalone customer is now consuming more rooms.

Shaleen Kumar

Sir, can this 65% go up to 85% individual?

Patanjali Keswani

My guess is that in the next five years, I think we are at bit of an inflection point, I am watching this space very closely. So, when you look at all numbers, whether it is a MakeMyTrip, whether it is an IndiGo, whether it is a Spice Jet, wherever these



consumers operate the rate of growth is so large that it is very likely, in my opinion, it will rise in these markets over 75%.

Shaleen Kumar

If I can squeeze in one more question, regarding MakeMyTrip, MakeMyTrip in their recent quarter they disclosed the discounting kind of spend which they do which is around roughly \$93 million. So, obviously a big chunk of this discounting is towards hotels where they will be giving a cash coupon or discounting. Now, let us assume this kind of discount, do you think your dependence on OTAs will impact your future growth?

Patanjali Keswani

Very valid point again. So, let me explain what MakeMyTrip is trying to do. So, online travel agents are basically to me a very exciting additional channel to reach out to individual customers. The cost of sales of direct booking through online travel agents is actually less than cost of sales for us when we do direct sales ourselves. Now, smart hotel operator should do the following as is done worldwide, use online travel agents to get a customer into your hotel and then do your utmost to make him brand loyal to you by either tying him up in some form or the other with some loyalty program or with a special rate and so on. This is a standard global practice. But broadly if you look at MakeMyTrip they would work into some kind of a ward for customers with Ibibo, then they got merged, now the next big threat to online travel agents in India is Booking.com which is as you know price wise it is a \$100 billion company in the US. Booking.com has announced they want to expand in the India market. So, this will become the next level of war, I guess like a Flipkart-Amazon, there will always be online travel agents competing for the customers. In fact, this discounting was not vis-à-vis hotels, this discounting was to acquire customers from each other. Going forward, I see whether it is MakeMyTrip or Booking.com, there will be some rationality because the rate of growth of these customers is so large, which is the internet consuming population and the internet consumers in India, this discounting will stop. When it stops, as happens in the rest of the world, there will be an increase shift toward lemontreehotels.com and to all other hotel brands, their websites. So, I do not see it as a threat. At the top of the cycle, the constraint is not the online travel agent, the constraint is supply. And the top of the cycle is coming very clearly in the next year or two, and at that point actually the person who controls supply is strangely enough more powerful than the person who controls the distribution, because it is a supply constraint environment.

Moderator

Thank you very much. Ladies & gentlemen, that seems to be the last question for today. I would now like to hand the conference over to the management for their closing comments.

Patanjali Keswani

Thank you once again for your interest and support. We will continue to stay engaged. Please be in touch with our investor relations team for any further details or discussions. And I look forward to interacting with you again soon.

Moderator

Thank you very much. Ladies & gentlemen, on behalf of Lemon Tree Hotels, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.