Lemon Tree Offer Expensive, Suitable for High-risk Investors

THE ISSUE
The issue is purely an offer for sale of 30,45,000 shares which would result in the exit of strategic investors such as Maplewood, Whispering Resort, Palm International and R2Corp.

BUSINESS
Lemon Tree Hotels offers rooms in three categories. These are Lemon Tree Premier (upper midscale), LemonTree Hotels midscale and Red Fox economy segment. The average occupancy of its rooms is 77%. The company has an inventory of 4,200 rooms, of which 1,800 are on management contract, while 2,400 are on net/leased. These rooms are located not only in metros but also in tier-II and tier-III cities. A large part of the company’s room inventory is owned, which makes its business model asset-heavy. Due to this and high employee and interest costs, the company has been recording losses. After a long time, demand in the hotels sector is matching the supply. Therefore, this is a favourable period for Lemon Tree. But investors should wait to see how the company takes advantage of the favourable business environment.

FINANCIALS
In the four fiscal quarters of FY17, the company’s total revenue grew by 17% on a year-over-year basis. It incurred losses in the period. For the first nine months of FY18, the company posted net profit of INR 25.8 crore.

VALUATION
The company’s enterprise value (EV) works out to be 20 times and 40 times (EV/EBITDA) respectively. The average EV/EBITDA of peers including Royal Orchid Hotels, Oriental Hotels, and TajGVK Hotels & Resorts is 18.2. Large hotel chains such as Indian Hotels and ITC have an EV/EBITDA of 24.4 and 15.2 respectively considering FY18 estimates according to Bloomberg data.

Therefore, Lemon Tree’s valuation looks aggressive.