News monitored for: Lemon Tree Hotels

Not economical to check in to Lemon Tree Hotels share sale

The fortunes of the cyclical hotel industry are on the verge of shifting for the better. Between fiscal year 2017 and 2021, rooms demand per day growth is expected to outpace rooms supply per day growth, thus boosting occupancy rates.

That's what Lemon Tree Hotels Ltd, which opens its initial public offering (IPO) today, is betting on. The hotel chain in the mid-priced segment is planning to add 3,038 rooms by fiscal 2023, taking its total room count to 7,735. It stands to gain when room rates increase owing to improving fundamentals.

Problem is, the expensive valuation that it is asking already seems to be pricing in the rosy picture. For perspective: at the upper end of its price band Rs54-56 per share, enterprise valuation (EV)/Ebitda works out to be 45 times financial year 2017 earnings.

That's 25-30% premium valuation compared to peers, pointed out ICICI Securities Ltd's retail equity research report.

Ebitda is short for earnings before interest, tax, depreciation and amortization.

You can forget about a listing pop, said Arun Kejriwal, director of Kejriwal Research and Investment Services Pvt. Ltd, adding "In fact, you will be lucky if you end up just with a minor loss." Right now, Lemon Tree is present in 28 cities across India and as on 31 January, had 45 hotels. It has three major brands—Lemon Tree Premier (upper-midscale segment usually comparable to 4-star and sometimes 3-star), Lemon Tree Hotels (midscale segment typically comparable to 3-star) and Red Fox (economy segment).

Compared to the valuations,

Lemon Tree’s financials are lacklustre.

Over FY12-FY17, revenue from operations increased at a compounded annual growth rate of nearly 18%.

But, for each of the previous five fiscal years, the company posted losses. Higher depreciation and interest costs make life difficult for Lemon Tree to cough up profits at the net level. It was able to eke out a small net profit of Rs2.8 crore for the nine months ended December (9MFY18), helped by a room rate hike.

Performance at the Ebitda level is far better. For FY17, the measure increased 15% year-on-year on the back of 12% revenue growth. Ebitda margin has been over 25% for 9MFY18 and the previous two fiscal years.

Still, that may not be enough for investors, considering the demanding valuations. Analysts expect the company to continue to incur substantial capex for its expansion, which could potentially increase its debt. As Kejriwal says, "It's worth remembering that Lemon Tree Hotels is not raising the money for itself, rather owing to its obligation for private equity investors.

Simply put, money received through this IPO wouldn’t end up with the company, as it is an offer for sale issue.

Lemon Tree derived as much as 71% of its total revenues from hotels for 9MFY18 from hotels located in the NCR, Bangalore and Hyderabad and any slowdown in these cities would be a problem. Further, competition in the sector is intense with the likes of Airbnb and Oyo Rooms around.

A confluence of these factors could well make investors cautious about checking in to the Lemon Tree IPO. It's also worth noting the issue comes in a rather busy month for initial share sales, so demand is likely to be muted.