



INDIAN HOTELS INDUSTRY: Economic slowdown hits profitability

Contacts:

Anjan Ghosh

aghosh@icraindia.com

+91-22-30470006

Subrata Ray

subrata@icraindia.com

+91-22-30470027

Pavethra Ponniah

pavethrap@icraindia.com

+91-44-24340043

Website

www.icra.in

OVERVIEW

The Indian hotels industry has been hit hard by the ongoing global economic slowdown, the increase in security requirements post-26/11, and the health concerns raised by the spread of the H1N1 virus. While the positive trend of the previous few years was maintained in the first half (H1) of 2008-09, the domestic hotels industry went into a downward spiral in H2, 2008-09. For the whole of 2008-09 however, the industry was able to sustain its average room rates (ARRs) albeit at the cost of occupancy, which fell by over 10%. In the first quarter (Q1) of 2009-10, there was again a marked drop in ARRAs as well as occupancies, which had a significant impact on the industry's Revenue per Room (RevPAR).

Continuing into the lean season, Q2, 2009-10 has also been a weak quarter for the industry. Attempts to shore up occupancies have had the effect of lowering ARRAs further over the Q1, 2009-10 levels in some markets, although RevPAR has shown a marginal q-o-q increase. However, with the start of the annual season in Q3, 2009-10, some revival is expected in the industry, especially with demand increasing from domestic businesses and leisure travellers. Besides, the decline in foreign tourist arrivals (FTAs) also appears to have moderated (going by the October 2009 data) while advance bookings for banquet facilities are showing signs of pick-up.

Overall, the past four quarters (H2, 2008-09 to H1, 2009-10) have seen significant erosion in the industry's profitability, and cash flow constraints have been universal. The impact of this down cycle has been greater on smaller companies (with a limited portfolio and high geographical concentration) and for those with weaker capital structures and large expansion plans. While a number of companies have deferred capital expenditure, those with projects in the construction phase have had to continue investing till launch. Additionally, despite adverse market conditions, several companies saw opportunity in the low valuations to invest in new assets, which in certain cases brought further strain onto their capital structures.

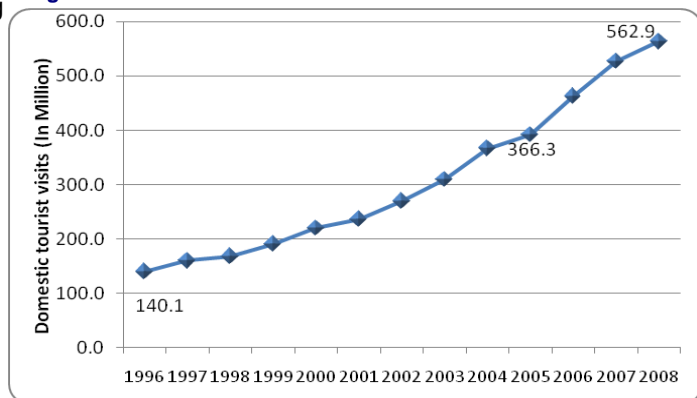
BACKGROUND

Entering the current down cycle on the back of an exceptional year (2007-08), most Indian hotel companies, especially those with stronger capital structures, had appeared well prepared for the lean phase ahead. However, the downturn has proved unique, both in its rapidity and pervasiveness. While in general the global hotel industry has suffered owing to the meltdown, the Indian hotels industry has had to cope with significant contraction because of events like the 26/11 terrorist attacks and the spread of the H1N1 virus, which only added to the impact of the downturn.

Being a cash-rich business, hotels normally exhibit high profitability and are able to maintain a comfortable liquidity position during an industry up-cycle. However, in a downcycle as volumes contract, the capital-intensive nature of the business with its high fixed operating costs weighs heavily on profitability. The hotels industry is normally among the first to be affected by an economic slowdown as travel is one of the main cost-heads to fall under the corporate axe during a downturn. Moreover, the industry is also among the slowest to recover because of the relatively discretionary nature of travel spending. The global hotels industry has experienced RevPAR growth for periods of five to eight years followed by one to two years of decline in RevPAR. Globally, demand has rarely kept declining for sustained periods. The long-term fundamentals of the hotels industry are interplay between hotel demand and supply, with the global economic scenario as the backdrop.

Contraction in volumes: Following more than a decade of increasing domestic tourist visitors and three years of continued increase in FTAs, foreign tourist volumes contracted sharply in calendar 2009. In H2, 2008-09, there was a sharp deterioration in the profitability, cash flows, and the capital structure of the Indian Hotels Industry. Further, Q1 of the current fiscal (2009-10) again saw industry-wide RevPAR contractions.

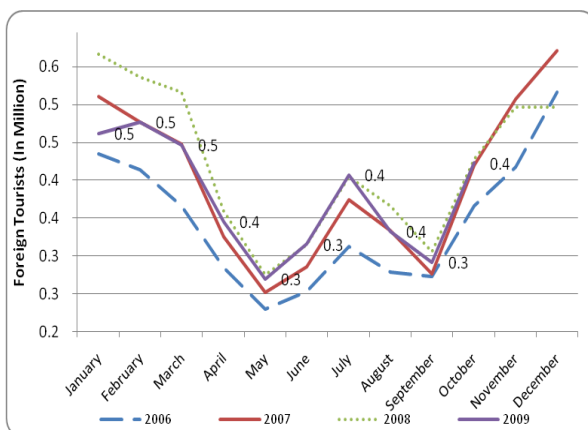
Figure 1: Domestic tourist visits



Source: Ministry of Tourism, Government of India
 Note: Years in the chart refer to Calendar years

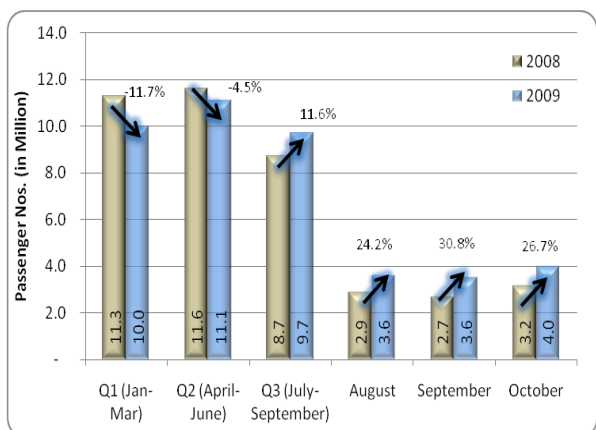
Current travel statistics remain weak, with domestic airline passenger traffic and FTAs in India falling by 2.7% and 7.9% respectively, in the period

Figure 2: FTA in India over the past four years



Source: Ministry of Tourism, Government of India

Figure 3:- Passengers carried by domestic airlines



Source: Ministry of Civil Aviation, Government of India

from January 2009 to September 2009 over the corresponding previous. However, the decline appears to have moderated somewhat, with the y-o-y monthly decline in FTAs at 1.1% in October 2009 versus 4.2% in September 2009. Domestic air traffic volumes have exhibited a positive growth over the past three months.

Fall in ARRs and Occupancies erode profitability: In an industry that has heavy upfront capital costs, any decline in RevPAR is likely to have an exponentially negative impact on profitability. Under conditions of controlled costs, any increase in RevPAR should at minimum match inflation, for sustained profitability.

In the current scenario of reduced demand and shrinking traffic, accentuated by high price-sensitivity, it is critical for the industry to manage heavy fixed costs. In this regard, ICRA notes that larger players with a presence across price segments (premium, business, luxury and economy), a mixed clientele (business, leisure, foreign, domestic, and crew), and a diversified revenue base (room revenues, F&B¹ revenues, and MICE² income) are better placed to withstand a slowdown. Companies with a larger and diversified room inventory are likely to perform better, as their costs are spread over a larger room base and across diverse locations. During the last few years, major hotels in India have made significant efforts towards revenue diversification by sharpening their focus on F&B revenues and MICE income.

At present, there are very few companies with a revenue base that is diversified across segments (ranging from the luxury to the economy category). These companies enjoy relatively higher stability in revenue and profitability. While the overall RevPAR trends in all the hotel segments move in tandem, volatility in the lower price segments is lower. Budget and economy hotels are more resilient to impact of cyclical, as their dependence on foreign tourists is low and as they also benefit from down-trending traffic. Smaller hotel companies, with a portfolio of one to three properties, are exposed to the risk of high concentration on a single market, which further increases their vulnerability to cyclical trends. With low brand visibility and limited funding flexibility, these companies are particularly vulnerable to an industry down-cycle. On the other hand, companies with comfortable cash accruals and sound capital structures are better equipped to withstand a down-cycle.

Short-term supply pipeline gets smaller owing to credit scarcity: Notwithstanding several infrastructural and clearance related constraints, the Indian hotels industry backed by over five years of buoyancy entered the current slowdown with a strong supply pipeline in all major cities. New hotels were being proposed by large Indian hotel companies (viz. Indian Hotels Company Limited (IHCL), EIH Limited and Leela Ventures Limited) and real estate developers alike. However, the credit crunch that came in the wake of the slowdown has been a dampener, and is estimated to have reduced the proposed room supply by ~40-50% in the short term. While most large hotel companies are likely to continue with their committed projects, albeit at a more cautious pace, real estate developers have stalled/deferred large project plans citing paucity of funds. This delay in projects is expected to prevent a simultaneous bunched-up increase in room supply over the short term.

However, with an estimated 90,000 rooms being in the pipeline covering the next five years, oversupply would remain a threat to the industry. Despite there being a large demand-supply gap in most pockets in India, the simultaneous launch of a few medium to large sized hotels has an impact on other properties in the vicinity until demand increases to absorb the additional supply. This situation is likely to crop up in several Indian cities over the next few years if even 50-60% of the proposed supply actually materialises, thereby prolonging the recovery period in some markets like Gurgaon, Bangalore, Hyderabad and Pune.

1 Food and Beverages

2 Meetings, Incentives, Conferences and Exhibition

Short-term outlook remains weak: Overall, considering the present market conditions, ICRA expects 2009-10 to remain challenging for the Indian hotels industry. Although H2, 2009-10 is likely to post an improvement over the corresponding previous, partly because of the low base effect (H2, 2008-09 had been weak), increase in ARR in the current season (H2, 2009-10 is the annual peak season for the industry) are likely to be muted as hotels attempt to revive occupancies. Further, as part of the proposed supply comes on-stream in various markets over the next year, the revival in the industry is likely to be subdued. The narrowing of the demand-supply gap would also prevent industry wide ARRs from shooting up as had happened in 2007-08. However, over the longer run this is likely to bring in a greater alignment between tariffs and the value provided.

Long-term outlook remains positive; significant room additions anticipated across regions: Despite the current trends in the industry, ICRA continues to have a positive view on the long-term fundamentals of the Indian hotels industry.

The long-term performance of the Indian hotels industry is linked to macroeconomic factors related to the general health of the economy and to micro market-specific, supply-demand gaps. ICRA expects demand in the long term to be driven by increasing travel volumes (low-cost airlines play an important role in boosting domestic travel); globalisation of trade and increase in tourist travel (India and Malaysia are set to emerge as key tourist destinations); and rising affluence and improving lifestyles of the travelling population (which drive demand for branded rooms and quality F&B).

Notwithstanding the long-term favourable outlook, the Indian hotels industry would remain exposed to exogenous shocks like terrorist attacks or health concerns, as evident from the aftermath of the 26/11 attack in India. Another point of concern is the lack of services and supporting infrastructure in India that would warrant the high prices Indian deluxe hotels currently command. These high prices, which are often comparable with those of premium international hotels, have led to the diversion of a significant number of MICE and leisure travellers to neighbouring value-for-money destinations like Thailand and Malaysia.

While the current global crisis is significantly impacting the economy and the demand for hotel rooms, the vast gap between the demand for and the supply of rooms in India persists. While the hotel industry in developed markets appear to have reached a point of saturation as far as demand and supply is concerned, the Indian hotels industry continues to evolve. The country currently has an estimated inventory of 125,000 branded rooms, which is well short of the requirement of almost twice the number in the next five years. In the short-to-medium term, the Indian hotels industry is likely to face several challenges ranging from the aftermath of this current down-cycle to more inherent problems like availability of low priced credit, government clearances, a plethora of taxes and economically viable land to build inventory. In the longer term, the growth potential is significant as evident from the continued global interest in the Indian hospitality industry. The industry has announced a pipeline inventory of over 90,000 new rooms (across categories) to be launched in the next five years, a significant number of which is coming from international hotel majors.

November 2009

Annexure 1: Industry Profile

The Indian hospitality industry covers various price segments (unbranded to 5 Star Deluxe) but continues to be dominated by a few premium segment players. The room inventory is skewed towards the 5 Star and 5 Star Deluxe segments. Indian Hotels Company Limited (IHCL) with more than 12,000 rooms is the largest and most diversified hospitality company in India with a presence spanning a wide price spectrum, ranging from super luxury to economy. IHCL is followed by the hotel divisions of ITC and EIH Limited who have around 1,500-3,000 rooms. Apart from these hotels, the industry has numerous participants with portfolio sizes ranging from one to 10 hotels.

Table 1 captures the performance of a sample of major Indian hotels during the four-year period from 2005-06 to 2008-09.

Table 1: Key Financial Indicators of the ICRA Sample of Hotel Companies (Aggregate)

Parameters	Unit	2005-06	2006-07	2007-08	2008-09
Operating Income	Rs billion	39.1	52.1	61.5	56.5
Operating Profit Margin	%	34.2%	36.0%	37.8%	29.9%
Net Profit Margin	%	17.3%	18.7%	17.8%	10.7%
Total Debt	Rs billion	42.3	47.2	70.7	91.0
Total Net Worth	Rs billion	40.5	46.0	54.3	67.2
RoCE	%	17.2%	21.8%	20.9%	11.7%
NCA/Total Debt	%	17.7%	21.7%	15.6%	8.4%
TD/(TNW + Minority Interest)	Times	1.0	1.0	1.2	1.3
OPBDITA / Interest and Finance Charges	Times	3.9	5.0	5.6	4.1
TD/OPBDITA	Times	3.2	2.5	3.0	5.4

RoCE: Return on Capital Employed; NCA: Net Cash Accruals; TD: Total Debt; TNW: Tangible Net Worth; OPBDITA: Operating Profit Before Depreciation, Interest, Tax and Amortisation

Note: ICRA sample consists of IHCL, EIH, EIH Associated Limited (EIHAL), Royal Orchid Hotels Limited (ROHL), Taj GVK Limited (Taj GVK), Oriental Hotels Limited (OHL), Hotel Excelsior Limited, Nehru Place Hotels Limited, Apeejay Surrendra Park Hotels Limited (The Park) and Hotel Leela Ventures Limited (Leela)

Source: Annual Reports of Companies

Table 2: Snapshot of Key Financials of Listed Hotel Companies- 2008-09

Parameters	IHCL (Consolidated)	EIH (Consolidated)	Leela (Consolidated)	Taj GVK	OHL	ROHL	EIHAL
Operating Income	27,054	11,763	4,598	2,381	2,150	1,418	1,665
Growth	-8.8%	-6.8%	-11.6%	-7.8%	-0.5%	8.3%	-9.6%
OPBDITA/OI	21.4%	35.5%	35.7%	43.1%	33.3%	31.6%	31.7%
PAT/OI	1.0%	14.4%	31.7%	22.3%	17.4%	14.1%	4.5%
Total Debt	47,669	11,409	24,495	1,390	657	1,053	2,620
Tangible Net Worth	31,702	11,742	7,022	2,694	2,788	2,049	944
RoCE	6.2%	21.3%	8.9%	33.6%	20.3%	12.3%	11.3%
RONW	0.9%	15.2%	20.5%	21.2%	13.8%	9.1%	8.1%
NCA/TD	2.4%	16.6%	7.9%	37.4%	49.1%	25.2%	6.6%
TD/(TNW + Minority Interest)	1.4	0.9	3.5	1.4	0.2	0.5	2.8
OPBDITA / Interest and Finance Charges	2.5	4.4	8.9	15.5	24.5	6.7	1.8
DSCR (excl STD/Prepayments)	1.5	1.5	1.3	11.1	18.5	2.2	0.7
Total Debt/OPBDITA	8.3	2.7	14.9	1.4	0.9	2.4	5.0
(Gross Cash Flows+ Interest)/Interest	1.4	2.3	23.1	13.7	19.4	5.1	1.5

PAT: Profit after tax; RONW: Return on Net Worth; DSCR: Debt Service Coverage ratio; STD: Short Term Debt

Note: Amounts in Rs. Million

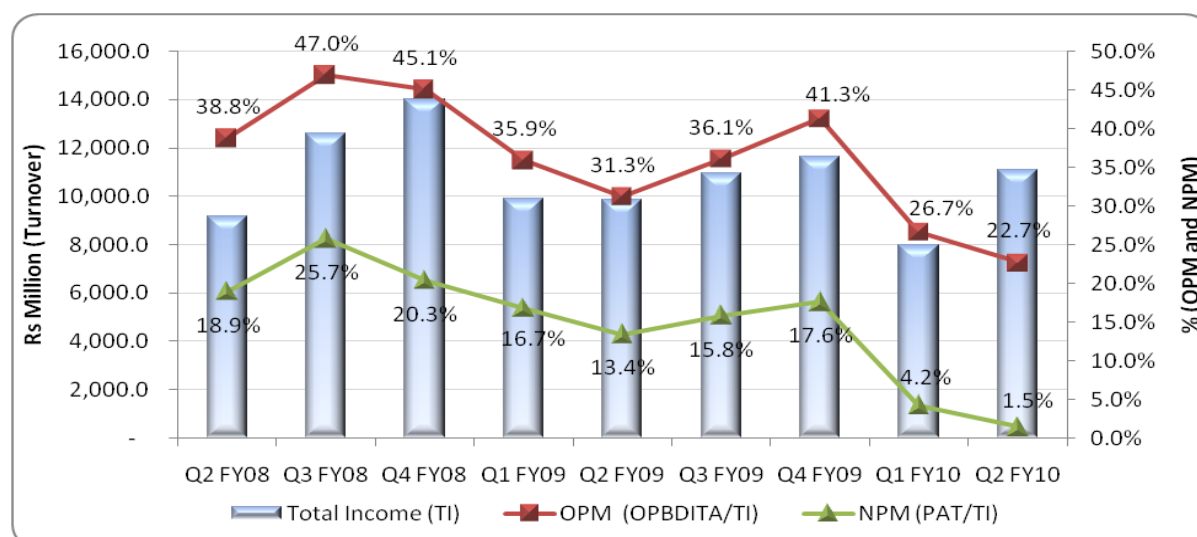
Source: Annual Reports of Companies

Table 3: Snapshot of Key Financials of Indian Hotel Majors (H1 2009-10)

Parameters	IHCL	EIH	Leela	Taj GVK	OHL	EIHAL	ROHL	Kamat Hotels
Net Sales	5,482.8	3,058.1	1,728.4	1,011.2	784.5	529.7	523.7	410.9
Decline in sales (Y-o-Y)	-16.6%	-38.8%	-24.8%	72.9%	-30.3%	-20.0%	-29.3%	-34.8%
Total income	5,920.7	3,852.6	1,758.3	1,015.5	788.1	533.3	523.7	433.8
OPBDIT	855.6	872.9	387.4	343.4	139.5	79.4	83.7	67.3
PAT	283.1	94.0	27.9	118.9	23.2	(81.6)	0.8	(121.4)
OPM	14.5%	22.7%	22.0%	33.8%	17.7%	14.9%	16.0%	15.5%
NPM	4.8%	2.4%	1.6%	11.7%	2.9%	-15.3%	0.2%	-28.0%
Decline in OPBDITA (Y-o-Y)	-58.6%	-46.8%	-59.8%	29.2%	-67.0%	-45.5%	-66.3%	-73.1%
Decline in PAT (Y-o-Y)	-74.7%	-86.4%	-96.4%	-21.2%	-94.3%	210.6%	-90.6%	-192.3%

Note: Amounts in Rs. Million

Source: Published results of companies

Figure 4: Quarterly trend in the operating performance of an aggregate sample of hotel companies

Sample consists of IHCL, EIH, Leela, Taj GVK, OHL, EIHAL, ROHL, Kamat Hotels Limited (Kamat)

In Q1, 2009-10, most hotel companies in India witnessed a large contraction in demand and reported a steep fall in ARR. Large-scale erosion in profitability was seen across the industry, with the OPM across the ICRA sample (aggregate) falling to 26.7% (Previous quarter 41.3%) and NPM to a low of 4.2% (Previous quarter 17.6%). In Q2 2009-10 the industry focused on increasing occupancies using discounted ARR, resulting in an industry wide growth in RevPARs. High fixed costs continued to drag down profitability which plummeted further in Q2 2009-10.

Table 4: ICRA Rated Entities in the Indian Hotel Industry

Company	Long Term	Medium	Short Term
Alcon Resorts Holdings Limited	LBB+		
Apeejay Surrendra Park Hotels Limited	LA+		
Cosmos Premises Private Limited	LBB+		
Daaj Hotels and Resorts Private Limited	LBB		
Divine Infracom Private Limited	LBB-		

Company	Long Term	Medium	Short Term
Eros Resorts & Hotels Limited	LBBB-		A3
Hotel Excelsior Limited	LA-		
Icon Hospitality Private Limited	LBBB		
IHHR Hospitality Private Limited	LA-		
Indian Hotels Company Limited	LAA+		A1+
Interglobe Hotels Private Limited	LBBB-		
Ksheer Sagar Developers Private Limited	LBB+		
Maruti Comforts and Inn Private Limited	LBBB-		
Muthoot Hotels and Infrastructure Ventures Private Limited	LBB+		A4+
Muthoot Hotels Private Limited	LBB+		A4+
Nehru Place Hotels Limited	LA-		
Oriental Hotels Limited	LAA-	MAA-	A1+
Royal Orchid Hotels Limited	LBBB+		A2
Satkar Realities Private Limited	LBB+		
Seven India Hospitality Private Limited	LBB		
Shree Naman Hotels Private Limited	LBB+		
Siesta Hospitality Services Limited	LBBB-		
Starex Developers Private Limited	LBB		
TAJ GVK Hotels & Resorts Limited	LAA-		A1+
Techpark Hotels Private Limited	LBBB-		



ICRA Limited

An Associate of Moody's Investors Service

CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300; Fax: +91 124 4545350

Email: info@icraindia.com, Website: www.icraratings.com, www.icra.in

REGISTERED OFFICE

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai:** Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 □ **Chennai:** Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 □ **Kolkata:** Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 □ **Bangalore:** Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 □ **Ahmedabad:** Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 □ **Hyderabad:** Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 □ **Pune:** Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231

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