

Lemon Tree Hotels Limited

Started in 2002, Lemon Tree Hotels Ltd. (LTHL) is India's largest hotel chain in the mid-priced hotel sector and the third largest overall, on the basis of controlling interest in owned and leased rooms. As of January 31, 2018, Lemon Tree operated 4,697 rooms in 45 hotels (including managed hotels) across 28 cities in India.

Positives – 1) Emerged as the leading mid-priced hotel chain in a short span of 14 years, 2) positive hotel industry dynamics with mid priced room demand expected to grow 11% CAGR ahead of supply till 2022, 3) differentiated business model in terms of property development (65% owned properties), employee selection specially the inclusion of opportunity deprived Indians, including differently-abled individuals, 4) well-diversified geographical location of hotel properties, 5) additions of new hotel properties will help in sustaining robust revenue growth in future.

Negative-1) LTHL has seen turnaround recently in M9FY2018 after making losses over the past several years at peaked 75%+ occupancy level which leaves little room for further improvement in occupancy, 2) it will continue to incur substantial capex in building up hotel properties for next few years which would lead to more leverage (IPO is only OFS and no new fresh equity is issued), 3) Indian hotel industry is becoming extremely competitive with the advent of likes of OYO rooms and Air BnB which limits company's pricing power, 4) low return ratios and promoter's stake holding.

Outlook & Valuation: It has seen turnaround in M9FY2018 by posting a PAT of ₹2.9 cr which was achieved at sort of peaked occupancy and 9% price hike (taken after September 2017). Hence, any further improvement in margins have to largely come via price hikes, which looks difficult specially in the lower range hotels, amid intense competition. At the upper end of the price band, the EV/EBITDA multiple works out be 44.5x EBITDA of FY2017 and ~38.6x on its FY2018 annualized EBITDA, which appears on the higher side even when compared to large listed hotel players like Indian Hotels (available at 33x FY2018 EV/EBITDA, others are available at 20-25x). **We recommend 'Neutral' on the issue for a mid-to-long term period.**

Key Consolidated Financial

Y/E March (₹cr)	FY2014	FY2015	FY2016	FY2017
Net Sales	222	290	368	412
% chg	3.2	31.0	26.7	12.0
Net Profit	(39.1)	(63.0)	(29.6)	(7.2)
% chg	100.2	61.1	(53.0)	(75.7)
OPM (%)	10.5	17.5	27.5	28.2
EPS (Rs)	(0.6)	(0.7)	(0.4)	(0.1)
P/E (x)	(89.7)	(82.9)	(142.1)	(534.1)
P/BV (x)	5.5	5.4	5.4	5.4
RoE (%)	(4.9)	(7.8)	(3.7)	(0.9)
RoCE (%)	(0.6)	(0.1)	3.4	4.1
EV/Sales (x)	21.9	16.9	13.6	12.6
EV/EBITDA (x)	208.0	96.9	49.5	44.5

Source: RHP, Angel Research; Note: * at upper end of the price band

Neutral

Issue Open: March 26, 2018

Issue Close: March 28, 2018

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹786.4cr

Offer for Sale: *18.5 cr shares

Fresh issue: Nil

Post Eq. Paid up Capital: ₹786.4cr

Issue size (amount): ₹1002-1039cr

Price Band: *₹54-56

Lot Size: 265 shares and in multiple thereafter

Post-issue implied mkt. cap: ₹4247 – 4404 cr

Promoters holding Pre-Issue: 31.1%

Promoters holding Post-Issue: 31.1%

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post-Issue Shareholding Pattern

Promoters	31%
Others	69%

Nidhi Agrawal

+022 39357600, Extn: 6872

nidhi.agrawal@angelbroking.com

Company background

Founded by Patanjali Govind Keswani in 2002, Lemon Tree operates under three brands that cater to the needs of different hotel segments—Lemon Tree Premier is targeted primarily at the upper-midscale hotel segment; Lemon Tree Hotels is targeted at the midscale hotel segment; and Red Fox by Lemon Tree Hotels is targeted at the economy hotel segment. As of 31 January 2017, Lemon Tree operated 4,697 rooms in 45 hotels (including managed hotels) across 28 cities in India. On the said date, it has 662992 members in loyalty programme as “Lemon Tree Smiles” and the number is continuously rising. Out of the total rooms, 3,200 rooms are owned, while around 1,500 rooms are managed.

Details of operation

The company offers three brands in three hotel segments:

- **‘Lemon Tree Premier’** which is targeted primarily at the upper-midscale hotel segment catering to business and leisure guests who seek to use hotels at strategic locations and are willing to pay for premium service and hotel properties;
- **‘Lemon Tree Hotels’** which is targeted primarily at the midscale hotel segment catering to business and leisure guests and offers a comfortable, cost-effective and convenient experience; and
- **‘Red Fox by Lemon Tree Hotels’** which is targeted primarily at the economy hotel segment.

Exhibit 1: Key Operating metrics

	Lemon Tree Premier			Lemon Tree Hotels			Red Fox Hotels		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
No of rooms available	681	877	877	1306	1306	1351	589	605	605
YoY Growth %		28.8%	0.0%		0.0%	3.4%		2.7%	0.0%
No of hotels	4	5	5	13	13	15	4	4	4
Average rooms per hotel	170	175	175	100	100	90	147	151	151
ADR -₹	3635	3834	4123	3175	3321	3522	2179	2278	2372
YoY Growth %		5.5%	7.5%		4.6%	6.1%		4.5%	4.1%
Average occupancy	68.30%	78.30%	74.60%	67.90%	73.30%	77.10%	67.80%	75.10%	79.10%
Rev pcc-₹	2482	3001	3075	2155	2433	2716	1477	1711	1877
YoY Growth %		20.9%	2.5%		12.9%	11.6%		15.8%	9.7%
Staff per room ratio	0.98	1.15	1.09	1.12	1.15	1.17	0.72	0.75	0.74

Source: Company, Angel Research

1 ADR represents revenue from room rentals divided by total number of room nights sold (including rooms that were available for only a certain portion of a period).

2 Average occupancy represents the total number of room nights sold divided by the total number of room nights available at a hotel or group of hotels.

3 RevPAR is calculated by multiplying ADR and average occupancy.

4 Staff per room is calculated by dividing total staff at the end of a fiscal year by number of available rooms as of March 31 of each fiscal year.

Turnaround posted in M9FY2018 but profitability still low

The company has reported turnaround in M9FY2018 on consolidated basis after making continuous losses for past several years. However, PAT margins were still very low at >1% in spite of peaked 75% occupancy level and 9% price hike in room rentals. Hence, any further improvement in profitability has to largely come via price hikes, which looks difficult specially in the lower range hotels. In spite of registering above industry average margins, the company's high debt (DE ratio of 1x in FY2017) and depreciation seems to be eating its PAT. This phenomenon is likely to continue in coming years as well due to its aggressive rooms addition plans (owned rooms to increase by 50% to over 4500 rooms by 2021).

Exhibit 2: M9FY2018 performance

	Lemon Tree Premier	Lemon Tree Hotels	Red Fox Hotels
No of rooms available	957	1,477	759
No of hotels	6	16	5
ADR1 -₹	4,639	3,715	2,777
Average Occupancy	77.0%	74.1%	75.6%
Rev PAR3	3,570	2,752	2,099
Average total hotel revenue per room- ₹	14,00,405	10,52,410	6,82,514
Revenue from room rental	70.1%	71.5%	82.7%
F&B revenue	20.4%	19.9%	10.4%
Other revenue	9.5%	8.5%	6.9%
Average operating expense / room- ₹	7,38,609	6,65,001	3,64,162
Operating expenses	52.70%	63.20%	53.40%
Staff per room ratio	1.12	1.18	0.72
Domestic guests	81.2%	84.3%	84.0%
Foreign guests	18.8%	15.7%	16.0%

Source: RHP

Issue Details

This IPO is an offer for sale of up to 18,54,79,400 Equity Shares of face value of Rs10 each by the Selling Shareholders. Issue would be worth ₹1002-1039 cr. OFS is being offered by some of its pre-issue investors and promoters.

Exhibit 3: Pre and post-IPO shareholding pattern

	No of shares (Pre-issue)	%	No of shares (Post-issue)	%
Promoter	24,43,05,803	31.1%	24,43,05,803	31.1%
Pre IPO Investors	54,21,06,880	68.9%	35,66,27,480	45.3%
Public			18,54,79,400	23.6%
Total	78,64,12,683	100.0%	78,64,12,683	100.0%

Source: RHP, Angel Research

Objects of the offer

This IPO intends to achieve the benefits of listing the equity shares on the stock exchanges via sale of equity shares by the selling shareholders.

Key Management Personnel

Mr. Patanjali Govind Keswani, aged 59 years, is the Chairman and Managing Director of the Company. He holds a bachelor's degree in electrical engineering from the Indian Institute of Technology, New Delhi and a postgraduate diploma degree in management from the Indian Institute of Management, Calcutta. He has been on our Board since 2002. Govind Keswani was a Tata Administrative Services Officer and associated with the Taj Group of hotels for a period of 17 years, including as the senior vice-president (special projects). Mr. Patanjali Govind Keswani was also associated with A.T. Kearney Limited, New Delhi as its associated consultant and director. At present, he is also the chairman of the Skill Council for Persons with Disability and a founding member of the Sector Skill Council for the Hospitality, Travel and Tourism industry. He has over 30 years of experience in the hospitality industry.

Mr. Rattan Keswani, aged 57 years, is an executive Director of the Company. He holds a bachelor's degree in commerce from DAV College, Panjab University and a diploma degree in hotel management from Oberoi School of Hotel Management. He has been on the Board since December 12, 2012. Prior to joining this Company, Mr. Rattan Keswani acted as the president of the Trident Hotels of the Oberoi Group, where he was engaged for a period 30 years

Mr. Ravi Kant Jaipuria aged 63 years, is a non-executive Director nominated by RJ Corp as a Director on its Board. Mr. Ravi Kant Jaipuria has been on our Board since December 23, 2003 and was last re-appointed with effect from September 30, 2016. He has an established reputation as an entrepreneur and business leader and is the only Indian to receive PepsiCos International Bottler of the Year award, which was awarded in 1997. He is a promoter and director of Varun Beverages Limited and RJ Corp.

Outlook & Valuation

It has seen turnaround in M9FY2018 by posting a PAT of ₹2.9 cr which was achieved at sort of peaked occupancy and 9% price hike (taken after September 2017). Hence, any further improvement in margins have to largely come via price hikes, which looks difficult specially in the lower range hotels, amid intense competition. At the upper end of the price band, the EV/EBITDA multiple works out be 44.5x EBITDA of FY2017 and ~38.6x on its FY2018 annualized EBITDA, which appears on the higher side even when compared to large listed hotel players like Indian Hotels (available at 33x FY2018 EV/EBITDA, others are available at 20-25x). **We recommend 'Neutral' on the issue for a mid-to-long term period.**

Key risks

Slowdown in economic growth in India

Since it would affect business and personal discretionary spending levels and lead to a decrease in demand for hotel services for prolonged periods.

Inability to take price hike amid rise in competitive intensity

The hotel industry in India is intensely competitive and LTHL competes with large multinational and Indian companies, as well as regional and local companies in each of the regions that it operate.

Any adverse changes in business prospects of its corporate customers

LTHL derives a significant portion (55%+) of its revenue from corporate customers, and any loss of such customers, the deterioration of their financial condition or prospects, or a reduction in their demand for its services could adversely affect its business.

Consolidated Income Statement

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017	M9FY18
Total operating income	222	290	368	412	352
% chg	3.2	31.0	26.7	12.0	
Total Expenditure	198	240	267	296	254
Food, Beverages & Provisions Consumed	79	96	111	117	
Personnel	65	78	85	97	
Selling and Administration Expenses	52	63	67	78	
Others Expenses	2	3	4	3	
EBITDA	23	51	101	116	98
% chg	(37.8)	117.4	99.5	15.0	
(% of Net Sales)	10.5	17.5	27.5	28.2	27.8
Depreciation & Amortisation	31	52	52	51	40
EBIT	(8)	(1)	49	ss65	58
% chg	(155.6)	(87.2)	-	33.6	-
(% of Net Sales)	(3.4)	(0.3)	13.3	15.9	16.5
Interest & other Charges	49	72	72	78	54
Other Income	21	13	6	10	1
(% of PBT)	(58.4)	(22.2)	(33.8)	(395.1)	11.8
Share in profit of Associates	-	-	-	-	1
Recurring PBT	(36)	(60)	(17)	(2)	5
% chg	57.9	68.8	(71.3)	(85.7)	
Tax	4	3	13	5	2
(% of PBT)	(10.4)	(5.3)	(72.6)	(189.9)	46.1
PAT (reported)	(39)	(63)	(30)	(7)	3
Less: Minority interest (MI)	0	(0)	(0)	(1)	
PAT after MI (reported)	(40)	(63)	(30)	(6)	
Extraordinary Items	(0)	(0)	(0)	0	
ADJ. PAT	(39)	(63)	(30)	(7)	3
% chg	100.2	61.1	(53.0)	(75.7)	
(% of Net Sales)	(17.6)	(21.7)	(8.0)	(1.7)	0.8
Fully Diluted EPS (Rs)	(0.6)	(0.7)	(0.4)	(0.1)	0.0
% chg	-	8.2	(41.7)	(73.4)	-

Source: RHP

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
SOURCES OF FUNDS				
Equity Share Capital	129	776	778	781
Reserves & Surplus	671	34	32	27
Shareholders' Funds	799	810	810	809
Minority Interest	290	422	428	428
Equity Share Warrants	-	-	-	-
Total Loans	559	571	625	799
Deferred Tax Liability	11	11	17	23
Total Liabilities	1,658	1,814	1,879	2,058
APPLICATION OF FUNDS				
Gross Block	1,287	1,410	1,282	1,518
Less: Acc. Depreciation	122	173	51	100
Net Block	1,164	1,236	1,231	1,418
Capital Work-in-Progress	135	167	259	351
Investments	38	31	6	6
Current Assets	104	64	65	74
Inventories	5	5	5	5
Sundry Debtors	16	18	24	31
Cash	72	30	14	18
Loans & Advances	11	11	21	20
Other Assets	-	-	-	-
Current liabilities	73	82	120	147
Net Current Assets	31	(19)	(55)	(73)
Deferred Tax Asset	(0)	0	(7)	(7)
Total Assets	1,658	1,814	1,879	2,058

Source: RHP

Consolidated Cash Flow Statement

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Profit before tax	(36)	(60)	(17)	(2)
Depreciation	31	52	52	51
Change in Working Capital	0	0	0	0
Interest / Dividend (Net)	41	64	67	70
Direct taxes paid	6	(13)	(12)	(4)
Others	(39)	(93)	(21)	18
Cash Flow from Operations	3	(51)	68	133
(Inc.)/ Dec. in Fixed Assets	(249)	(170)	(132)	(235)
(Inc.)/ Dec. in Investments	144	20	30	6
Cash Flow from Investing	(105)	(150)	(103)	(229)
Issue of Equity	13	12	3	0
Inc./(Dec.) in loans	288	89	82	236
Dividend Paid (Incl. Tax)	38	0	3	0
Interest / Dividend (Net)	45	135	(38)	(74)
Cash Flow from Financing	161	159	19	100
Inc./(Dec.) in Cash	59	(42)	(16)	4
Opening Cash balances	14	72	30	14
Closing Cash balances	72	30	14	18

Source: RHP

Key Ratios

Y/E March	FY2014	FY2015	FY2016	FY2017
Valuation Ratio (x)				
P/E (on FDEPS)	(89.7)	(82.9)	(142.1)	(534.1)
P/CEPS	(528.0)	(381.3)	196.1	100.4
P/BV	5.5	5.4	5.4	5.4
EV/Sales	21.9	16.9	13.6	12.6
EV/EBITDA	208.0	96.9	49.5	44.5
EV / Total Assets	2.9	2.7	2.7	2.5
Per Share Data (Rs)				
EPS (fully diluted)	(0.6)	(0.7)	(0.4)	(0.1)
Cash EPS	(0.1)	(0.1)	0.3	0.6
DPS	0.0	0.0	0.0	0.0
Book Value	10.2	10.3	10.3	10.3
Returns (%)				
ROCE	(0.6)	(0.1)	3.4	4.1
Angel ROIC (Pre-tax)	(0.6)	(0.1)	3.5	4.1
ROE	(4.9)	(7.8)	(3.7)	(0.9)
Turnover ratios (x)				
Asset Turnover (Gross Block)	0.2	0.2	0.3	0.3
Inventory / Sales (days)	8	6	5	4
Receivables (days)	26	23	24	28
Payables (days)	135	114	131	142
Working capital cycle (ex-cash) (days)	(101)	(86)	(101)	(110)
Solvency ratios (x)				
Net debt to equity	0.6	0.6	0.7	1.0
Net debt to EBITDA	19.2	10.1	6.0	6.7
Interest Coverage (EBIT / Interest)	(0.2)	(0.0)	0.7	0.8

Source: RHP, Angel Research

Research Team Tel: 022 - 39357800

E-mail: research@angelbroking.com

Website: www.angelbroking.com

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