INDIAN HOTELS INDUSTRY

Pricing power on slow recovery

QUARTERLY REVIEW | JULY 2011

ICRA RATING FEATURE

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Summary

- The Indian hotels industry is still in the nascent stages of recovery and is yet to make the transition from an occupancy-led cycle to one supported by rising average room realizations (ARRs)
- We believe sustained demand and a relatively longer booking window point to the return of some pricing power during the current year. However, supply pressures in some cities are likely to negate the impact of the same and also prevent any steep increases in room tariffs.
- Weak macroeconomic signals emanating from the USA and Europe, expectations of the domestic corporate sector reporting a lacklustre performance in fiscal 2011-12 (year to March 31, 2012), rising interest rates, increase in food and fuel costs, and unrest in West Asia continue to cloud the near-term prospects for the Indian hotels industry
- The longer-term prospects of the industry however remain robust, given that it can absorb significant capacity additions in a scenario of robust economic growth; besides, the industry's room inventory remains low by global standards

Overview

The global hotels industry appears to be now on a path of slow recovery, having coming out of two exceptionally bad years (2009-10). While the main recovery leaders are the emerging countries in the Asia-Pacific region, the developed luxury hotel markets of the USA and Europe have also reported signs of demand recovery during the past 12 months.

In India, the demand - or occupancy - led recovery that started with the return of domestic travellers late in calendar 2010, received a boost with foreign tourist arrivals (FTAs) picking up in the subsequent months. The latter half of 2010-11 saw the industry push for higher tariffs, although pricing recovery for the whole of 2010-11 stood at a tepid 5-8%. From our analysis of demand, supply and industry profits, and considering the fact that the previous recovery cycles lasted six to eight years, ICRA believes that the current recovery is still in a nascent stage and yet to make the transition from an occupancy-led up-cycle to a more convincing ARR-led recovery. The market requires further improvement in occupancy and confidence to be able to gain real pricing power. Overall, ICRA expects the Indian hotels industry to post a modest recovery in performance during the next three quarters, aided by high single-digit ARR growth.

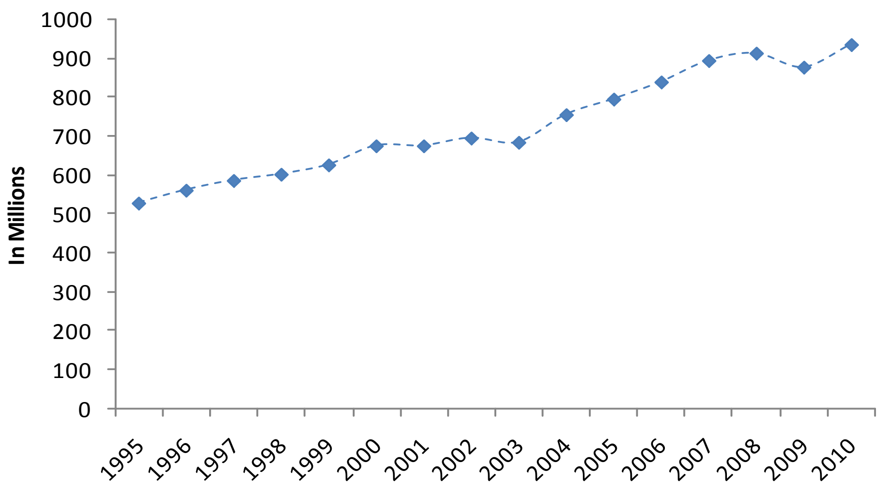
One of the key risks to recovery come from demand dampeners, namely, expectations of relatively mute corporate performance in fiscal 2011-12 (which could slow down corporate spending), increase in interest rates, rise in fuel and food prices (which would impact disposable incomes), and subdued macroeconomic signals from the developed markets. For recovery to be sustained, it must be supported by gains in the underlying economy. Additionally on the supply front, heavy supplies in markets like the National Capital Region (NCR), Hyderabad, Pune, Bangalore and Chennai are expected to suppress pricing power.

Global markets report strong demand recovery, but pricing yet to gain traction

Globally, hotel demand witnessed a recovery during the calendar year (CY) 2010 with international tourist arrivals growing by 7% to 935 million, against a disappointing 4.2% de-growth in the previous calendar. Demand continued to be strong in the first two months of CY2011, posting a healthy 5% growth, with France, the USA and China being the world's three major tourist destinations (in terms of visitor arrivals). The growth was supported primarily by the emerging economies where traffic rose 6%, against 4% reported by the developed nations. Indian travellers have emerged the sixth biggest spenders when travelling abroad[1]; even as they remain highly price-conscious when travelling within the country. The trend of growing spends by Indian outbound travellers points to the potential that this segment offers for domestic tourism in the years to come.

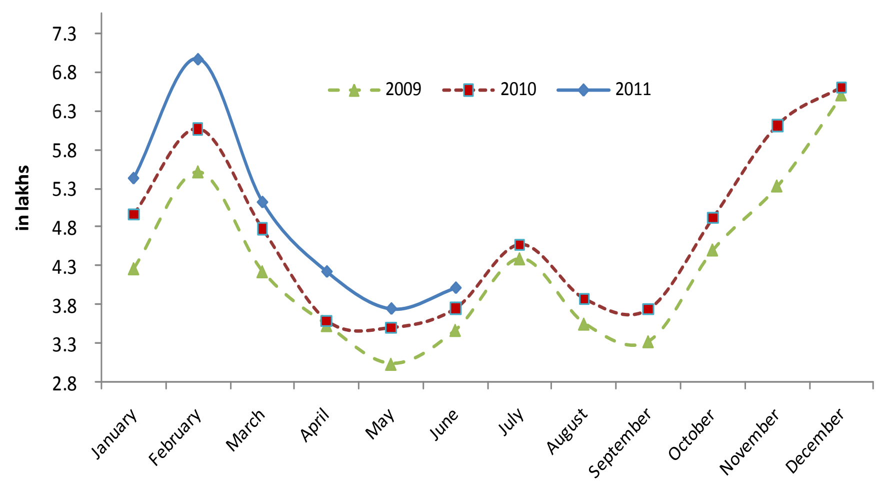
With sustained demand, the global hotels industry has witnessed some recovery in pricing power (as countries like the USA, China, Australia and Singapore, to name a few markets), particularly in the luxury segment, with the luxury premium increasing substantially over that commanded by the upper scale segment. Transient demand

Chart 1: International Tourist Arrivals



Source: UNWTO and ICRA's estimates

Chart 2: Foreign Tourist Arrivals into India



Source: Ministry of Tourism , Government of India, and ICRA's estimates

has also revived, although group bookings in the global scenario are trudging slower, with corporates still cautious about non-discretionary spending. Normally, while group rooms, bought in bulk and with an advance booking window, are priced at a significant discount to transient bookings, during the last recessionary trough (2009-10) the premium that transient bookings commanded got completely eroded; in fact, transient prices fell below contracted group rates in some global markets during this period. While transient pricing has now recaptured part of the lost premium, the same remains below historical levels. According to global industry experts,

[1] *According to Hotel Price Index by Hotels.com*

transient pricing is unlikely to revert to past highs before mid-2013. Despite dampeners like the March 2011 earthquake in Japan, the West Asian crisis and some weak macroeconomic indicators pointing to an anaemic recovery in the USA and Europe, the United Nations World Tourism Organisation (UNWTO) forecasts a 4-5% growth in global traveller volumes in CY2011.

Demand recovery apparent in the India market

The Indian hotels industry appears to have embarked on a recovery cycle, triggered largely by the revival in domestic travel (both leisure and business) since the second half (H2) of fiscal 2009-10; FTAs have also improved since December 2009, and were up 7.9% to 55.8 lakh travellers during CY2010. Although the October 2010 Commonwealth Games were expected to provide a strong demand push to the Indian hotels industry, weak planning and execution diluted the benefits to hotels in the NCR and the rest of the country. On the other hand, the Cricket World Cup in the fourth quarter (Q4) of 2010-11 provided a much stronger demand impetus, with hotels reporting high occupancies in Chandigarh, New Delhi and particularly Mumbai (during the Finals in early April 2011). FTAs have remained strong during the first six months of CY2011, growing by 10.9%. In this context, while the return of foreign tourists clears the deck for the much-needed ARR premiums, the importance and stability the domestic traveller imparts to the Indian hotels industry remains intact. Despite the worrying signals from the global economy, ICRA expects demand in several Indian markets to report healthy growth during 2011-12, supported both by domestic and foreign travellers. The Formula 1 racing event scheduled to be staged in the NCR in October 2011 is an enabling factor in this regard.

Supply pipeline drags recovery

Globally, the Asia-Pacific region is one of the key areas expected to witness a large addition to room supply during the next few years. Two regions in India—the NCR with a pipeline of over 9,900 rooms (across categories), and Mumbai with a active pipeline of around 3,800 rooms—are two of the busiest hotel construction markets in the Asian sub-continent at present. A significant part of the NCR pipeline was conceived with some sporting mega-events of 2010 and 2011 in sight: the Commonwealth Games (October 2010), the Cricket World Cup (Q4, 2010-11), the annual Indian Premier League matches, and the Formula 1 race (October 2011). Thus, the NCR witnessed a significant increase in room capacity during 2010-11 itself, with the inventory of premium rooms increasing to over 10,000 (as of March 2011). Going by the plans announced and the site visits made, ICRA expects the NCR to add another 5,000 premium/luxury rooms or so by 2015. The figure takes into account the 13 hotels being constructed within the hospitality district of Delhi International Airport's 'Aerocity'; these are expected to be commissioned during 2012-13.

As for Mumbai, it has 9,000-9,500 premium hotel rooms (as of March 2011), including the 1,000-odd rooms commissioned during 2010-11. Bulk of this supply is in North Mumbai. ICRA expects Mumbai to add over 3,500 new premium rooms by 2015, with the additions being made by Accor, Radisson, Marriott, Shangri-La and Hyatt, among others.

ICRA expects NCR and Mumbai, both being gateway regions—and the country's national and financial capital, respectively—to witness strong demand in the coming years. However, with supply also being strong, especially in the NCR (where supply is expected to grow by 50%), ICRA expects this market to experience a weak recovery, with tariff growth likely to be anaemic during 2011 and 2012. Besides, the viability of certain high-cost hotel projects in the NCR is also uncertain. High real estate prices and increase in the costs of construction materials and commodities have pushed up the project costs and break-evens for these new hotels significantly. This could lead to some distress in the absence of strong pricing power over the medium term.

Going by industry sources and ICRA's own field visits, there are some other tier-1 pockets as well where a supply overhang may be expected namely Chennai, Hyderabad, Bangalore and Pune. Chennai with around 2,400 rooms is set to double its inventory by 2015. Chennai's luxury landscape is set to witness a major change with properties like the ITC Grand Dakshin, Leela, JW Marriott, Hyatt Regency, Radisson and Park Hyatt expected to open by 2014 (in phases). Although Chennai has multiple feeder markets of manufacturing and services providing it with strong demand drivers (demand grew 15% in the luxury segment during 2010-11), ICRA expects this large expected supply to effectively mute ARR recovery in this market over the medium term. Besides, with the bulk of these properties coming up in the luxury space, there could be some dilution between premium and luxury pricing. Moreover, ICRA is also concerned about the ability of a relatively small market like Chennai to absorb such large projects (with over 400-600 rooms in one location and costing over Rs. 1.25 crore per key). However, a number of these hotel projects have planned for considerable commercial or office space, which should fetch alternative, and more stable, revenues.

Pune, Bangalore and Hyderabad are three other key markets that are expected to witness significant incremental supply by 2015. All these three markets have added significantly to their luxury room supply during the last two years also. Luxury room supply in Hyderabad grew 11% and 28% in 2009-10 and 2010-11 respectively, while that in Pune went up by 39% and 31% and that in Bangalore by 43% and 17% respectively, during the two years. Further, Hyderabad is set to add around 2,500 rooms to its existing inventory of around 3,000, while Pune is expected to add around 1,500 rooms to its existing 3,000. Pune and Bangalore are largely dependent on foreign business (IT/ITES) tourists. The possibility of an economic slowdown in the USA has led to muted guidance from the Indian IT/ITES sector for the current fiscal, raising concerns over hotel demand in these two markets. Adding to which Hyderabad continues to face unrest because of the Telangana issue, and saw several Meetings, Incentives, Conferencing and Exhibition (MICE) events in the city being cancelled in 2010-11.

Table 1: Expected Scenario in Premium Hotel Segment in Select Indian Markets

Market	Demand Drivers	Prospects	Outlook
Mumbai	Gateway city and financial capital	Supply likely to be absorbed	Although there is supply lined up in North Mumbai and Navi Mumbai, being a gateway city and the country's financial centre, demand is likely to be robust.
NCR	Gateway city	Oversupply likely in the near term	While supply is still spilling over from the Commonwealth Games period, the NCR is expecting to add around 5,000 rooms over the next three to four years. This is likely to suppress pricing power, slowing the recovery over the immediate term. However, over a longer period, growing demand should absorb the supply.
Bangalore	Foreign IT/ITES business travellers	Oversupply likely in the near term	Bangalore has seen significant room additions in 2009-11 and is likely to see more over the next few years, which would prolong the recovery.
Pune	Foreign IT/ITES business travellers	Heavy oversupply likely	With supply additions still on, the outlook for the next two years is subdued. Pune is one of the few markets that saw occupancies and ARRs decline in Q1, 2010-11 because of supply addition.
Chennai	Manufacturing and services sectors	Oversupply likely in the near term	With a strong supply pipeline for 2012 and 2013, the city is likely to experience significant pricing pressure over the next two years. Incumbents with lower cost structures are likely to benefit.
Hyderabad	Manufacturing and services sectors	Oversupply likely in the near term	This market still has a large supply pipeline and hence recovery is likely to be slow till 2013. Incumbents and new developers with lower cost structures/break-even are likely to benefit.

Market	Demand Drivers	Prospects	Outlook
Goa	Domestic and foreign tourists	Supply limited and demand growing	Demand remained strong during the October-May 2011 peak season. Limited supply and foreign tourists are likely to keep the city's prospects healthy.
Kolkata	Business travellers	Supply likely to be absorbed	Kolkata though a relatively small market, also has limited additions in the immediate term, with most of the supply being back-ended for and beyond 2015.

Source: Industry and ICRA's estimates

Chart 3: Monthly ARR Trends in Indian Premium Hotels

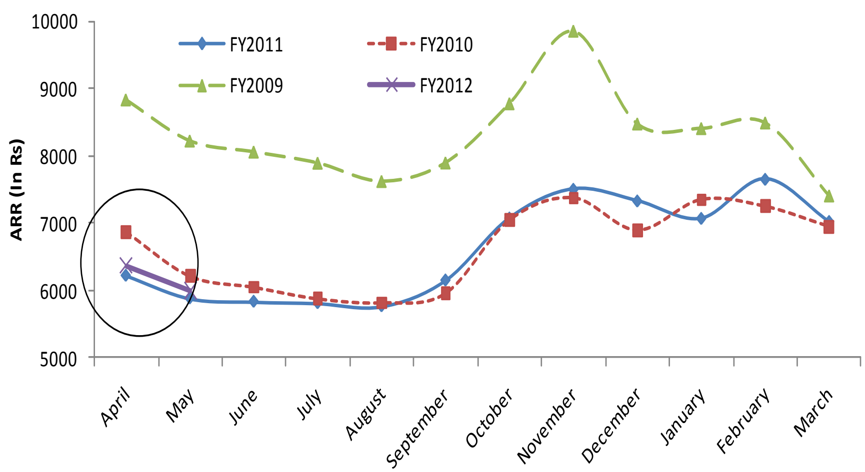
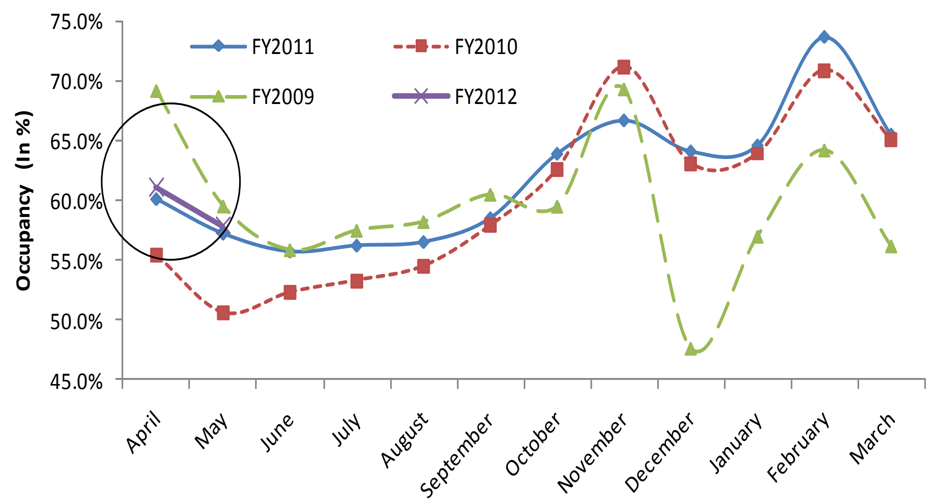


Chart 4: Monthly Occupancy Trends in Indian Premium Hotels



Source: Smith Travel Research and ICRA's estimates

Occupancy gaining pace even as pricing lags

As *Chart 4* shows, the Indian hotels industry has shown signs of occupancy recovery during September'10-May'11, supported by strong demand. However, the recovery in ARRs continues to be substantially lower than the decline witnessed during the recession. In fact, blended ARRs for 2010-11 have only shown a marginal 5-7% recovery from the lows of the 2009-10. However, over the past few months there has been a visible narrowing of the tariff discounts between H2, 2008-09 and H2, 2010-11. It should however be noted that in H2, 2008-09, ARRs had already been dampened by the start of the global recession and the 26/11 attacks in Mumbai.

Revenues revive in 2010-11, but higher operating expenses pare margins

Emerging out of a two-year downturn, the Indian hotels industry was able to report a healthy revenue growth of around 20% in 2010-11 on the strength of a combination of factors. These included a revival in domestic and foreign tourist arrivals, moderate rate increases of 5-7%, revenues from incremental supply, and stable food and beverage (F&B) revenues. However, despite the marginal tariff increases, growth in operating profits for the industry was subdued in 2010-11 with higher operating expenses (mainly higher wages and fuel costs, besides inflation-hit F&B costs) eroding profits. Further, with the recovery primarily being occupancy-led, the incremental costs of customer servicing (at lower revenue per room) pared operating profits.

Table 2: Snapshot of Key Financials of Indian Hotel Majors (2010-11)

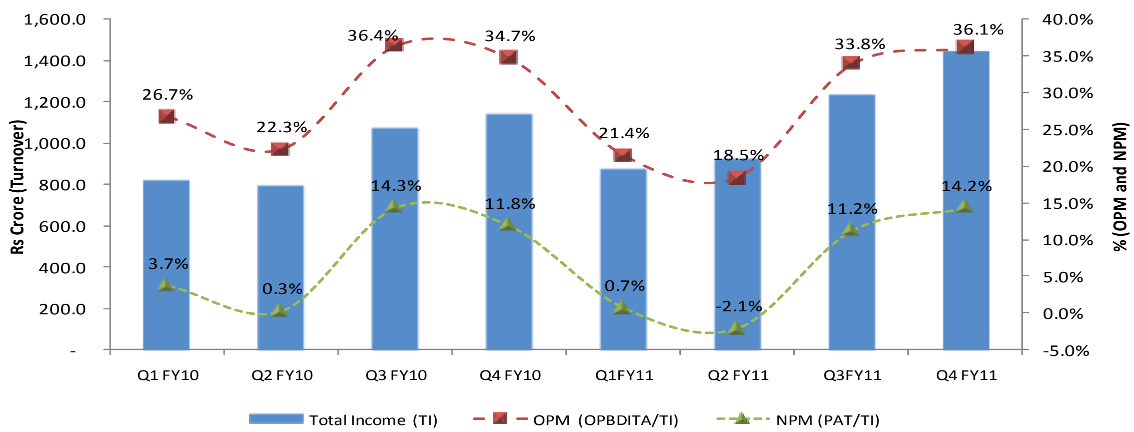
Parameters	IHCL (Consol)	EIH (Consol)	Leela (Consol)	Taj GVK	OHL (Consol)	EIHAL (Consol)	ROHL (Consol)	Kamat
Net Sales	2,862.5	1,126.3	525.8	259.3	276.1	174.7	152.1	120.9
Sales Growth	*17%*	*33%*	*17%*	*14%*	*24%*	*12%*	*26%*	*18%*
Total income	2,862.5	1,288.0	525.8	260.7	279.3	176.3	152.1	127.7
OPBDITA	455.7	301.3	155.1	97.6	72.6	55.0	39.4	38.4
PAT*	(87.3)	(5.2)	37.8	43.3	29.2	12.0	11.5	(14.5)
OPBDITA %	16%	23%	29%	37%	26%	31%	26%	30%
PAT %	-3%	0%	7%	17%	10%	7%	8%	-11%
OPBDITA Growth	*11%*	*2%*	*25%*	*13%*	*17%*	*16%*	*44%*	*26%*
PAT Growth	*-37%*	*-108%*	*-8%*	*19%*	*46%*	*384%*	*133%*	*55%*

EIH (Consol): EIH Limited (Consolidated); EIHAL (Consol): EIH Associated Limited (Consolidated); IHCL (Consol): Indian Hotels Company Limited (Consolidated); Kamat: Kamat Hotels Limited; Leela: Hotel Leela Ventures Limited; OHL (Consol): Oriental Hotels Limited (Consolidated); ROHL (Consol): Royal Orchid Hotels Limited (Consolidated); Taj GVK: Taj GVK Hotels & Resorts Limited

*Note: Amounts in Rs. crore; *PAT net of minority interest;*

Source: Published results of the companies and ICRA estimates

Chart 5: Trends in Revenues and Profits for the Indian Hotels Industry



Source: ICRA's estimates, Capitaline Database. Sample of selected hotels

Quarterly trends show revenues improving but profits pared by higher customer servicing costs

The hotels industry is characterised by seasonality, with the second half of a financial year being the peak season. The industry's quarterly performance in 2010-11 when compared with that in 2009-10 shows steady improvement—an indication that the industry is in the early stages of recovery. The overall revenues and the revenues per available room in Q3 and Q4, 2010-11, are however still lower than the respective figures reported by the same quarters in 2007-08, which remains one of the best periods for the Indian hotels industry in recent times. Although ARRs posted some improvement, cost pressures (employee, fuel and F&B expenses) muted margin recovery during H2, 2010-11.

Outlook

ICRA expects the sustained high occupancies of the past 18 months to lend some pricing power to the Indian hotels industry during the current fiscal (2011-12), which in turn would dilute the impact of increasing fuel, food and employee expenses. Depending on the markets they operate in, while some hotels are likely to witness an increase in revenues and profits during the current quarter (Q1, 2011-12), others are likely to see their revenues and profits remain stable (as compared with the previous year). In certain key markets, like the NCR, Pune, Hyderabad, Bangalore and Chennai, large supplies of rooms in the coming quarters of 2011-12 would prevent any significant increases in tariffs. Further, the global economic and political environment, especially in key regions like the USA, Europe and West Asia, remains uncertain, and adverse developments there can slow down business and tourist arrivals into India, thereby affecting demand here.

The longer-term outlook for the Indian hotels industry remains positive, given the country's burgeoning middle class and its emergence as an economic powerhouse, the increase in disposable incomes, the continuing investments in infrastructure, and the large existing gap between the demand for and supply of hotel rooms. As long as India is able to maintain a healthy rate of economic growth, demand would absorb new supplies of hotel rooms over the medium term.

Annexure

ICRA's Ratings in Hotel Industry (as on 18th July 2011)

Company	Long Term	Outlook	Short Term
Alcon Resorts Holdings Limited	LBB+	Stable	
Altron Industries Private Limited	LAA(SO)@		
Amethyst Hospitality Private Limited	LBB-	Stable	
Apeejay Surrendra Park Hotels Limited	LA+	Stable	
Aria Hotels and Consultancy Services Private Limited	[ICRA]BBB-	Stable	
Asian Hotels (West) Limited	[ICRA]BBB+	Stable	
Associated Hotels Private Limited	LB		A4
BD & P Hotels (India) Private Limited	LC		
Bestech Hospitalities Private Limited	LBB+	Stable	
Celsia Hotels Private Limited	LBBB- (SO)		
Chalet Hotels Limited	LBBB+	Stable	A2
City Heart Hotels Private Limited	LC		
Cosmos Premises Private Limited	LBBB+(SO)	Stable	
CSJ Infrastructure Private Limited	LBBB	Stable	
Cyberhills Developers Private Limited	LBBB- (SO)		
Daaj Hotels and Resorts Private Limited	LB+		
Dev Fun Point Reality Private Limited	LB+		
Divine Infracom Private Limited	LC		
Dreamz Achievers India Private Limited	LB+		
DS (Assam) Hospitality India Limited	LBB+	Stable	
DS Hotels & Resorts (India) Limited	LBBB-	Stable	
DSF Grand Plazas Private Limited	LBB	Stable	
Eros Resorts & Hotels Limited	LBBB-	Stable	A3
Fruitful Buildcon Private Limited	LBB	Stable	
GMR Hotels and Resorts Limited	LBBB(SO)		
Gayatri Hi-Tech Hotels Limited	LC		
Godavari Shilpkala Limited	LBBB-	Stable	
Golden Jubilee Hotels Limited	LBB+	Stable	A4+
Golden Tree Hotels Private Limited	LB		
Greenland Hospitality Private Limited	LB+		

Company	Long Term	Outlook	Short Term
HB Estate Developers Limited	LBBB-	Stable	
Hotel Airport Kohinoor Private Limited	LBB+	Stable	
Hotel Excelsior Limited	LA-	Stable	
Hotel Imperial Palace (I).	LB+		
Hotel Raj Park Private Limited	LBB	Stable	
Hotel Sukhamaya Private Limited	[ICRA]D		
Hotel TipTop International Private Limited	LBB-	Stable	
Icon Hospitality Private Limited	LBBB	Stable	
IHHR Hospitality Private Limited	LBBB+	Stable	
Indian Hotels Company Limited	LAA+	Stable	A1+
Innmar Tourism and Hotels Private Limited	LBBB-	Stable	
Interglobe Hotels Private Limited	LBBB-	Stable	
JSK Hotels Private Limited	LBBB-	Stable	A3
Jaksons Developers Private Limited	LBB	Stable	
Kandhari Hotels Private Limited	LBB+	Stable	A4+
KBJ Hotel & Restaurants Limited	LBB-	Stable	
Kohinoor Elite Hotel Private Limited	LBB	Stable	A4
Ksheer Sagar Developers Private Limited	LBBB+(SO)	Stable	
Malabar Hotels Private Limited	LC		A5
Maris Hotels & Theatres Private Limited	LBB+	Stable	
Maruti Comforts and Inn Private Limited	LBBB-	Stable	
MG Group	LB+		
Middle East Hotel Company Private Limited	LBB	Stable	
Muthoot Hotels and Infrastructure Ventures Private Limited	LBB+	Stable	A4+
Muthoot Hotels Private Limited	LBB+	Stable	A4+
Nama Hotels Private Limited	LBBB+(SO)	Stable	
Neesa Leisure Limited	LBBB+	Stable	A2

Company	Long Term	Outlook	Short Term
Nehru Place Hotels Limited	LA-	Stable	
New Age Hotels and Resorts Limited	LBB	Stable	
Nitesh Residency Hotels Private Limited	LBB-	Stable	
Oriental Hotels Limited	LAA-/MAA-	Stable	[ICRA] A1+
R S Kalyaani Hotels Private Limited	LBB-	Stable	
R.K. Associates	LC		
Roots Corporation Limited	LBBB+	Stable	
Royal Orchid Ahmedabad Private Limited	LBBB+(SO)	Stable	
Royal Orchid Hotels Limited	LBBB+	Stable	
S. P. Jaiswal Estates Private Limited	LBBB+	Stable	A2+
Sagar Ratna Hotels Private Limited	LBB+	Stable	
Satya Prakash Hotels Private Limited	LBB+	Stable	
Sawhney Builders Private Limited	LC		
Seabird Resorts Private Limited	LBB	Stable	A4
Serveall Land Developers Private Limited	LBB	Stable	
Seven India Hospitality Private Limited	LC		

Company	Long Term	Outlook	Short Term
Shekhar Resorts Limited	LC+		
Shipra Hotels Limited	LBB	Stable	
Shirdi Country Inns Private Limited	LC		
Siesta Hospitality Services Limited	LBBB-	Stable	
St Laurn Hotels Limited	LB+		A5
Sunair Hotels Limited	LBBB+	Stable	A2+
Supreme Real Estate Developers Private Limited	LBB-	Stable	
TAJ GVK Hotels & Resorts Limited	LAA-	Stable	A1+
Techpark Hotels Private Limited	LBBB-	Stable	
Triton Hotels & Resorts Private Limited	LBB+	Stable	
Velacity	LB-		
Viorica Properties Private Limited	LBB-	Stable	A4
Waterline Hotels Private Limited	LBB-	Stable	
Westside Hotels and Resorts Private Limited	LB		

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