April 27, 2017

Lemon Tree Hotels

Summary of Rated Instruments

Instrument*	Amount Rated (Rs. crore)	Rating Action
Term Loans	95.04 (reduced from 99.60)	[ICRA]A-(Stable) upgraded from [ICRA]BBB+(Stable)
Long Term/Short Term: Fund based Working Capital	30.00	[ICRA]A-(Stable)/[ICRA]A2+ upgraded from [ICRA]BBB+(Stable)/[ICRA]A2
Long Term/Short Term: Unallocated	8.44 (enhanced from 3.88)	[ICRA]A-(Stable)/[ICRA]A2+ upgraded from [ICRA]BBB+(Stable)[ICRA]A2
Total	**133.48**	

*Instrument Details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating outstanding from [ICRA]BBB+ (pronounced ICRA triple B plus)[1] to [ICRA]A- (pronounced ICRA A minus) on the Rs. 95.04 crore[2] (reduced from Rs. 99.6 crore) fund based bank facilities of Lemon Tree Hotels Limited ("LTHL" / "the company"). The outlook on the long term rating is 'Stable'. ICRA has also upgraded the long term rating outstanding from [ICRA]BBB+ (pronounced ICRA triple B plus) to [ICRA]A- (pronounced ICRA A minus) and the short-term rating outstanding from [ICRA]A2 (pronounced ICRA A two) to [ICRA]A2+ (pronounced ICRA A two plus) for the Rs. 30 crore working capital facilities and Rs. 8.44 crore of proposed facilities of the company.

Rationale

While assessing the credit profile of LTHL, ICRA has consolidated the operational and financial profile of the concern and its subsidiaries owing to significant financial linkages between them.

The rating upgrade takes into account the consistent improvement in operating metrics of the properties of LTHL owing to stabilisation of new properties as well as shift in business mix with lower dependence on low yield corporate and crew business. Supported by a favourable demand outlook for the domestic hospitality industry, LTHL is expected to record a sustained improvement in its profitability and credit metrics over the medium term. The ratings also factor in the growing recognition of the company's brands —Lemon Tree Hotels, Lemon Tree Premier Hotels and Red Fox Hotels—across the country, coupled with favourable location of the properties in prominent business districts that provide remunerative catchment. Although the properties in Delhi, Hyderabad and Bangalore account for a significant chunk of the company's revenues, which exposes it to risks of adverse regional movements, the hotel portfolio is reasonably diversified across categories (upscale/midscale/economy) with presence in dispersed micro-markets that reduces the vulnerability of revenues to cyclical downturns to some extent. Furthermore, as the upcoming projects become operational over the next four years, coupled with expansion through management contract route, geographical diversification benefits are expected to accrue to LTHL over the medium to long-term.

During 9M FY2017, the revenues of the company witnessed a healthy growth of 15% over the corresponding previous fiscal, supported by improved performance of the properties at Hyderabad (HITEC City and Gachibowli), Bangalore and Delhi International Airport Limited (DIAL). Moreover,

[1] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.
[2] 100 lakhs = 1 crore = 10 million

commencement of operations of the City Centre, Gurgaon, property following its reconstruction, supported the revenue growth during 9M FY2017. In line with the scale up in operations, the operating profit margin of LTHL witnessed improvement to 31.6% during 9M FY2017 (27.1% during 9M FY2016) and the company reported break-even at net profit level. The ratings also derive comfort from LTHL's comfortable capital structure as reflected in gearing of 0.6x as on December 31, 2016, given its strong equity base. Furthermore, the ratings continue to derive strength from the funding support as demonstrated by the promoters as well as investors by way of equity infusion at regular intervals, which has facilitated rapid expansion of the company's portfolio, while enabling the group to maintain a comfortable capital structure.

The ratings, however, remain constrained by the moderate return on capital employed (ROCE) as investments in new properties are yet to scale up adequately for meaningful contribution to profitability. Against the backdrop of these debt-funded investments and insignificant contribution to profitability, the company's coverage indicators such as Total Debt/OPBITDA (at 6.1x as on December 31, 2016; significant portion of debt raised for funding projects under development) remain suppressed. Notwithstanding the moderate coverage indicators, ICRA draws comfort from the longer tenure of debt, comfortable moratorium period following commencement of commercial operations, coupled with a ballooning repayment structure. Additionally, with a favourable demand outlook for the domestic hospitality industry as well as a positive outlook on average room rates, the benefits of operating leverage are expected to play in and profit margins of the properties are expected to improve during FY2018, thereby supporting a gradual improvement in the coverage indicators.

Although the group has aggressive organic growth plans on the anvil that pose significant execution risk, a major proportion of the equity proceeds has already been deployed towards project funding which provides comfort. This has been in line with the group's policy of deferring debt drawdown towards later stages of project execution. The availability of sanctioned lines against cash flows of operational properties as well as flexibility to raise debt against projects launched in FY2018 and other debt-free operational properties provide adequate financial flexibility to fund the under construction projects, thereby mitigating funding risks to a large extent. Furthermore, project debt, if required, can be availed towards end of project execution when the visibility of cash flows is higher, which would also enable the company to secure a reasonable moratorium period. As such, the possibility of cash flow mismatch risk arising due to delays in completion or scaling up of properties remains marginal. Owing to debt-funded capex plans, ICRA expects that leverage to remain high despite expectations of improved profitability.

Going forward, the group's ability to report sustained improvement in operating performance of the existing properties, thereby attaining improved profitability and debt-coverage metrics, successfully mobilising funds to execute the planned room additions without incurring any significant time and cost over-runs and prudently planning organic as well as inorganic expansion, shall remain the key rating sensitivities.

Key rating drivers

Credit Strengths

- Consistent improvement in operating metrics of the properties supported by shift in business mix with lower dependence on low yield corporate and crew business.
- Stabilisation of properties aiding improvement in profit margin.
- Strong equity base as well as policy of relying on debt against cash flows of operational properties for funding ongoing projects which enables deferment of debt drawdown towards completion of capex.
- Diversified product portfolio with properties across different categories (upscale/midscale/economy) which reduces vulnerability of the revenues to cyclical downturns to an extent; Multiple properties in prominent business districts allows the company to withstand any demand vulnerability related to micro markets.
- Established track record of the promoters and key management personnel in the hospitality industry.

Credit Weaknesses

- Profitability metrics yet to improve meaningfully; return on capital employed remains moderate coupled with modest debt-coverage indicators despite improvement (TD/OPBITDA of 6.1x as on December 31, 2016); Nevertheless, longer tenure of debt remains a positive. Vulnerable to time and cost overruns with several under construction projects; however, management's successful track record in execution provides comfort.
- Significant debt-funded expansion plans may lead to moderation in credit metrics if the demand recovery is slower than expected

Description of key rating drivers:

The rating upgrade takes into consideration a healthy year-on-year improvement in operating metrics of LTHL's properties and consequent improvement in its scale of operations, which together with high operating leverage inherent in the business, have resulted in an improvement in profitability. With expectations of an improved demand–supply scenario, the operating metrics in the domestic hospitality market are likely to be on an upward trajectory, which is expected to support profitability over the medium term. Furthermore, the ratings continue to derive strength from the demonstrated funding support in the form of equity infusion by promoters as well as other investors at regular intervals in the past.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below

Links to applicable Criteria

Corporate Credit Rating methodology
Rating Methodology for Hotel Industry

About the company:

Established in 2002 by Mr. Patanjali Keswani and his friends and associates, Lemon Tree Hotels Limited (LTHL, erstwhile Lemon Tree Hotels Private Limited) is a privately held concern that owns and operates hotels under three brands namely Lemon Tree Premier (upscale), Lemon Tree (midscale) and Red Fox (economy). In terms of ownership, ~31% stake in the company is held by the promoters (Keswani family), ~25% by Warburg Pincus, ~15% by APG (a Dutch pension fund) and the balance is owned by the Shinsie Bank of Japan, employees and promoters' friends and associates.

The company designs, develops, and manages properties under its own books as well as its subsidiaries' books (collectively referred to as the Lemon Tree group). While most of the properties in the portfolio are owned by the company directly or through subsidiaries, a few are operated on long-term lease basis. At present, the group has 27 operational properties, with operational inventory of 3,172 rooms, while 6 properties are under development (with approx 1,400 rooms).

With a view to facilitate rapid expansion of LTHL's brands across the country, the group's subsidiary Carnation Hotels Private Limited enters into management contracts with asset owners. At present, the group has a portfolio of 10 properties under management agreements, all of which operate under the Lemon Tree Hotel, Red Fox Hotel or Lemon Tree Premier Hotel brands.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable
Rating history for last three years:
Table:

S. No	Name of Instrument	Current Rating (2018)			Chronology of Rating History for the past 3 years		
		Type	Amount rated (Rs. crore)	Date & Rating	Month-year & Rating in FY2017	Month-year & Rating in FY2016	Month-year & Rating in FY2014
				April 2017	May 2016	April 2015	March 2014
1	Term Loans	Long Term	95.04	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund based Working Capital	Long Term/Short Term	30.00	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable) /[ICRA]A2	[ICRA]BBB+ (Stable) /[ICRA]A2	[ICRA]BBB+ (Stable) /[ICRA]A2
3	Unallocated	Long Term/Short Term	8.44	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. crore)	Current Rating and Outlook
Term Loan 1	-	-	FY2024	24.45	[ICRA]A-(Stable)
Term Loan 2	-	-	FY2024	24.80	[ICRA]A-(Stable)
Term Loan 3	-	-	FY2021	25.00	[ICRA]A-(Stable)
Term Loan 4	-	-	FY2026	20.79	[ICRA]A-(Stable)
Fund based Working capital Facilities	-	-	-	30.00	[ICRA]A-(Stable)/[ICRA]A2+
Unallocated	-	-	-	8.44	[ICRA]A-(Stable)/[ICRA]A2+

Source: Lemon Tree Hotels Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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