Lemon Tree Hotels Limited

June 15, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term Loan	95.04	99.37	[ICRA]A- (Stable); reaffirmed
Long-term/ Short -term – Fund Based Working Capital	30.00	30.00	[ICRA]A- (Stable) / [ICRA]A2+; reaffirmed
Long-term/ Short-term – Unallocated	8.44	4.11	[ICRA] A- (Stable) / [ICRA]A2+; reaffirmed
Total	**133.48**	**133.48**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating outstanding of [ICRA]A- (pronounced ICRA A minus)[1] on the Rs. 99.37-crore[2] (enhanced from Rs. 95.04 crore) term loan facilities of Lemon Tree Hotels Limited (LTHL or the company). ICRA has also reaffirmed the long-term and short-term rating outstanding of [ICRA]A- and [ICRA]A2+ (pronounced ICRA A two plus) on the Rs. 30.00-crore fund-based working capital facilities and the Rs. 4.11-crore (reduced from Rs. 8.44 crore) unallocated limits of LTHL. The outlook on the long-term rating is Stable.

Rationale

The rating reaffirmation takes into account the consistent improvement in operating metrics of LTHL's properties in FY2018 owing to healthy demand across most operative micro-markets which enabled implementation of an average 14% hike in average room revenues (ARR) in H2 FY2018, along with shift in business mix towards high profit accretive mid-scale corporate (MSME) and independent traveler segment (from relatively low paying corporate and crew business). Supported by a favourable demand outlook for the domestic hospitality industry, coupled with full year impact of ARR escalations and stabilisation of newly launched properties in the National Capital Region (NCR) during FY2018, LTHL is expected to record a steady improvement in its profitability and credit metrics over the medium term. Furthermore, with four of the seven ongoing projects expected to become operational over the next 12 months, the project implementation risk stands substantially reduced. The ratings also favourably factor in the successful public listing of the company in FY2019 (enhanced brand visibility and improved financial flexibility), comfortable capital structure, extensive experience of the promoter in the hospitality industry and well-recognised brands—Lemon Tree and Red Fox. ICRA notes the favourable location of the properties (in prominent business districts that provide remunerative catchment), and portfolio expansion through asset-light leasing of properties and management contract route. Although the properties at Delhi Aerocity, Hyderabad (Hitech City and Gachibowli) and Bangalore (Ulsoor Lake and Electronic City) account for a significant proportion of the company's revenues (~45% in FY2018), which exposes it to the risks of adverse regional movements, the hotel portfolio is reasonably diversified across categories (upper mid-scale/midscale/economy) with presence in dispersed

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[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

[2] *100 lakh = 1 crore = 10 million*

micro markets. The same reduces the vulnerability of revenues to cyclical downturns or regional events to some extent. Further, as the upcoming projects become operational over the next three years, alongside expansion through management contract route, geographical diversification benefits are expected to accrue to LTHL over the medium to long-term.

These ratings are, however, constrained by moderate return indicators as investments in newly launched properties (Sector 60, Gurgaon, and Banjara Hills, Hyderabad) are yet to scale up adequately for meaningful contribution to profitability. Moreover, the execution risk would reduce following planned launch of four (778 rooms) of the seven under construction properties over the next year and the company plans to leverage the new properties to fund its remaining capex. This debt-funded expansion over the medium term (FY2019-FY2020) is expected lead to increased financial leverage (TD/ OPBITDA of 6.5-7.0 times) of LTHL, despite higher profits and cash accruals accruing from matured portfolio. With a substantial portion of the capital being tied-up in newly launched inventory, the returns on the additional investment will be slower, leading to moderate coverage indicators and return on capital employed (RoCE) over next two years. However, notwithstanding the moderate coverage indicators, ICRA draws comfort from flinancial flexibility to raise debt against projects scheduled to be launched in FY2019 and other debt-free operational properties, its ability to negoitiate favourable debt terms interms of competitive rates, longer tenure, comfortable moratorium period following commencement of commercial operations, coupled with a ballooning repayment structure.
Going forward, the ability of the company to quickly stabilise its newly launched properties and consistently improve the performance of its mature room portfolio would be key moniterables. Additionally, successful mobilisation of funds to execute planned room additions without incuring significant cost and/or time overruns and prudently planning the pace and manner of its future expansions, so as to limit impact on its business and financial risk profile, will remain the key rating sensitivities.

Outlook: Stable

ICRA expects LTHL to continue to benefit from the geographically diversified and differentiated brand portfolio and healthy industry scenario, besides its experienced promoter. The outlook may be revised to Positive if significant growth in its revenues and profitability and timely completion and ramp-up of its on-going projects strengthen its financial risk profile. The outlook may be revised to Negative in case the new properties take longer to stabilse and/or delays in completion of ongoing projects and higher debt drawdown moderates the company's financial risk profile.

Key rating drivers

Credit strengths

Consistent improvement in operating metrics; full year impact of price hike undertaken in H2 FY2018 to drive performance in FY2019 - The consolidated ARRs (on net basis) and occupancies of LTHL's properties improved from Rs. 3,385 and 77%, respectively, in FY2017 to over Rs. 3,540 and 75%, respectively, in FY2018. The growth in matrices was supported by healthy growth across major properties in Delhi, Bangalore and Hyderabad driven by average price hike of 14% undertaken at company-wide level in September–October 2017 and favourable guest mix. Healthy operating performance and cash accruals led to improvement in its profit margins and debt servicing ability (interest cover of 1.7x; DSCR of 1.2x, and NCA/Total Debt of 6% as on March 31, 2018). While the performance in FY2018 was impacted because of slow ramp-up of the newly launched Lemon Tree and Red Fox properties in Sector 60, Gurgaon, the overall performance is expected to improve in FY2019, benefiting from full year impact of higher ARRs across properties, stabilisation of inventory launched in FY2018 and continued healthy returns from matured room inventory.

Robust capital structure; public listing improves financial flexibility - Healthy equity infusions from private equity players in the past has helped the company maintain a comfortable capital structure (TOL/TNW of 1.0 times) despite undertaking significant capex towards expansion. Additionally, its policy of relying on debt against cash flows of operational properties for funding ongoing projects, deferment of project debt towards later stages and its ability to raise low cost debt, continues to be a credit positive for LTHL. ICRA also takes cognisance of public listing of equity shares of LTHL, which is expected to enhance brand visibility and improve its financial flexibility, in terms of better access to capital and liquidity for shareholders.

Reduced project implementation risk over 12 months; strategy to expand through management contract and leasing expected to limit capital requirement and minimise risk – With four of the seven projects under implementation nearing completion over next 12 months, the project implementation risk faced by the company is expected to stand significantly reduced. Furthermore, the company plans to expand through asset-light models that involves leasing of properties or entering into management contract with property owners. These models are expected to provide long term operational benefits to LTHL, as properties can be quickly put in operations with minimal (or nil) capex and no project implementation risk. Furthermore, the company would be able to conserve its funds while increasing its network, allowing scope for faster scale-up of revenues and profitability.

Well-recognised brands and geographically diversified product portfolio - LTHL is one of India's largest hotel chains, with 48 operational properties (as on March 31, 2018) across 32 cities. The company has established well-recognised mid-scale (Lemon Tree) and economy segment (Red Fox) brands and benefits from a robust distribution system, loyalty programmes and corporate relationships. Additionally, the diversified presence reduces the vulnerability of the Group's revenues to cyclical downturns to some extent, while favourable location of properties (existing and under development) in the prominent business and tourist districts supports revenue growth and reduces concentration risk.

Credit challenges

Moderate financial profile characterised by high leverage and weak RoCE - Given a large inventory in early stabilisation phase (422 rooms added in FY2018 at Sector 60 and Leisure Valley, Gurgaon, and Banjara Hills, Hyderabad) and debt availed against operational properties support operations and fund on-going capex, the RoCE has remained low (5.8% in FY2018). In addition, with plans to mobilise sizeable debt as the under-construction projects near completion (over FY2019-FY2020), the consolidated leverage (TD/ OPBDITA), at ~7.8x as on March 31, 2018, is likely to remain high despite higher operating profits. However, the same is expected to peak-out over next 1-2 years and improve thereafter as the nascent inventory (0-1-year-old rooms) stabilises and starts contributing to the operating profits. Furthermore, the long tenure debts sanctioned to the company at competitive rates (and moratorium) allow for comfortable debt coverage ratios (interest cover and debt-service coverage ratio of 1.7 times and 1.2 times, respectively, in FY2018) and remain a credit positive.

Considerable front-ended capex planned over the medium term; pressure on operating cash flows likely due to significant nascent stage inventory - On a consolidated level, nearly 1,434 rooms (34% targeted owned room inventory of 4,230) remained under development as on March 31, 2018, with estimated capex outlay of ~Rs. 850 crores over next three years. Though project risks in terms of time and cost overruns stand to reduce substantially with four properties (~778 rooms) becoming operational over the next 12 months, the fresh inventory is likely to stabilise over time, putting pressure on operating cash flows in the interim. Nonetheless, favourable location of these new properties—in high demand geographies of Mumbai, Pune, Kolkata and Udaipur—is expected to expedite their stabilisation and provide healthy profits.

Vulnerability of revenues to inherent industry cyclicality, economic cycles and exogenous events - Operating performance of the properties remain vulnerable to seasonal industry, general economic cycles and exogenous factors (geo-political crisis, terrorist attacks, disease outbreaks, etc.). Nonetheless, the risk to revenues is partially mitigated by LTHL's geographically diversified portfolio in prominent business districts, which allows it to withstand any demand vulnerability related to a particular micro-market.

Analytical approach: For arriving at the ratings, ICRA has analysed the consolidated business and financial profile of the Lemon Tree Group, i.e., LTHL along with its subsidiaries and step-down subsidiaries. ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology
Rating Methodology for Entities in the Hotel Industry

About the company

Incorporated in 2002 by Mr. Patanjali Keswani and his friends and associates, Lemon Tree Hotels Limited (LTHL) is a publically listed company that owns and operates hotels under three brands—namely Lemon Tree Premier (upper mid-scale), Lemon Tree (midscale) and Red Fox (economy) across 32 cities in India. In terms of ownership, ~31% stake in the company is held by the promoters (Keswani family), ~12.5% by Warburg Pincus, ~15% by APG (a Dutch pension fund) and the rest is owned by foreign portfolio investors, mutual funds, employees and the public.

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 28 operational properties and seven properties under development. The total inventory across the operational properties stood at 3,277 rooms as on March 31, 2018. The 1,525 rooms under implementation/negotiation are expected to be added to the portfolio over the next three years.

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. As on March 31, 2018, the Group had a portfolio of 20 properties (1,593 rooms) under management agreements, with another 18 properties (with ~1,340 rooms) under negotiation.

Key financial indicators (Audited)

Consolidated	FY 2017	FY 2018 (Prov)
OI (Rs. crore)	412.1	484.3
PAT (Rs. crore)	-5.0	14.5
OPBDIT/ OI (%)	28.3%	28.1%
RoCE (%)	5.0%	5.8%
Total Debt/ TNW + Minority Interest (times)	0.7	0.8
Total Debt/ OPBDIT (times)	6.9	7.4
Interest Coverage (times)	1.5	1.7

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability- Capital Work-in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Jun-18	Date & Rating in FY2018 Apr-17	Date & Rating in FY2017 Jun-16	Date & Rating in FY2016 Apr-15
1	Term Loans	Long-term	99.37	99.37	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund based bank facilities	Long-term and short term	30.00	--	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2
3	Unallocated Limits	Long Term and short-term	4.11	--	[ICRA]A- (Stable)/ [ICRA]A2+	[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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-I	Nov 2017	NA	FY2024	22.05	[ICRA]A-(Stable)
NA	Term Loan-II	Mar 2014	NA	FY2024	21.45	[ICRA]A-(Stable)
NA	Term Loan-III	Apr 2016	NA	FY2026	20.10	[ICRA]A-(Stable)
NA	Term Loan-IV	Apr 2017	NA	FY2025	10.77	[ICRA]A-(Stable)
NA	Term Loan-V	Apr 2015	NA	FY2021	25.00	[ICRA]A-(Stable)
NA	Overdraft	NA	NA	NA	30.00	[ICRA]A-(Stable)/A2+
NA	Unallocated Limits	NA	NA	NA	4.11	[ICRA]A-(Stable)/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.

For more information, visit www.icra.in

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