ICRA

Lemon Tree Hotels Limited

January 03, 2019

Summary of rating action

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

*Instrument details are provided in Annexure-1

Material Event

Lemon Tree Hotels Limited (LTHL) has entered into a Joint Venture (JV) agreement with Warburg Pincus LLC, a global private equity firm, to develop Institutional grade rental housing accommodations/co-living spaces for students and young professionals in India. The total investment outlay for the venture is indicated to be Rs. 3,000 crores, which is to be invested in two phases over next few years. The JV company, Hamstede Living Pvt. Ltd, will be owned by Magnolia Grove Investment Ltd, an affiliate of Warburg Pincus and LTHL in the proportion of 68%:30%. The balance 2% will be held by Mr. Patanjali Keswani, managing director of LTHL, in his personal capacity.

Impact of Material Event

The ratings remain unchanged at [ICRA]A-(Stable)/[ICRA]A2+ following the company's announcement, as no significant fund outflow is expected from LTHL over the next 1.5-2 years. The development of these rental spaces would be through various routes – greenfield projects, leasing/acquisition of existing spaces or management of existing on-rent spaces. To begin with the JV intends to develop a customised and scalable business model for the Indian market and establish its brand in this segment. The initial investment is expected to be marginal (Rs. 20-25 crore by all JV partners). The bulk of phase-I investment, of Rs. 1,500 crore, is expected to commence in second half of FY2021 (between 2-7 years from now). The contribution from LTHL would be largely through internal accruals and/or fund raising from capital markets. The management remains committed to its policy of maintaining comfortable capital structure by deferring debt-drawdowns, if any, towards later stages of project execution.

ICRA believes that rental housing business, which is in nascent stages in India, offers significant opportunities and could be revenue and profit accretive for LTHL over the medium to long term. While the JV partner has experience of creating similar platforms in other Asian countries, development of a scalable and successful on-rent housing business model for Indian market and extent of synergistic benefits to LTHL remains to be seen. Going forward, the company's leverage position will improve, supported by healthy cash accruals from stabilised hotel portfolio. ICRA also takes comfort from the fact that equity share has been deployed for all the six greenfield hotel projects currently under development. With limited funding requirements for the JV, the financial profile of the LTHL is expected to remain stable over the near to medium term.

The previous detailed rating rationale is available on the following link : Click here.

Key rating drivers

Credit strengths

Consistent improvement in operating metrics in H1 FY2019 - The consolidated average room rate (ARR) and occupancy of LTHL's properties improved from Rs.3,504 and 75.2%, respectively, in H1 FY2018 to over Rs. 3,919 and 77.5%, respectively, in H1 FY2019. 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. 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 in FY2019, which has enhanced brand visibility and improved 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 three of the six 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 51 operational properties (as on September 30, 2018) across 31 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 modest RoCE - Given a large inventory in early stabilisation phase (423 rooms added in FY2018 at Sector-60 and Leisure Valley, Gurgaon, and Banjara Hills, Hyderabad) and debt availed against operational properties to support operations and fund on-going capex, the RoCE has remained low (6% in H1 FY2019). In addition, with plans to mobilise sizeable debt as the under-construction projects near completion (over FY2019-FY2020), the consolidated leverage (TD/ OPBDITA), at ~7.4x as on September 30, 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. Notwithstanding the higher debt levels, the long tenure with moratorium as well as competitive finance rates) allow for comfortable debt coverage ratios (interest cover and debt-service coverage ratio of 1.9 times and 1.2 times, respectively, in H1 FY2019).

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 1,235 rooms (29% targeted owned room inventory of 4,230) remained under development as on December 30, 2018, with estimated capex outlay of ~Rs. 733 crores over next three years. Though project risks in terms of time and cost overruns stand to reduce substantially with one property (Pune, 199 rooms) already operational and three properties (~579 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 specific micro-market.

Liquidity Position

LTHL's had a consolidated term debt outstanding of Rs. 1164 crore as on December 30, 2018. The repayments due over next 2 years (FY2020-FY2021) aggregating approximately Rs. 130 crore. The ballooning repayment terms on all its loans ensure that repayment burden increases only incrementally, while the properties stabilise. Furthermore, backed by its performance, the company was able to renegotiate the interest rates or refinance its debt at lower cost such that average cost of debt borrowing declined from 11.6% p.a. in FY2017 to 9.5% p.a. in FY2018 and further to 9.2% in H1 FY2019. ICRA expects healthy performance across properties, given the robust demand scenario, especially across key micro-markets of Delhi NCR, Bangalore and Hyderabad. Company earned cash profits of Rs. 35 crore in H1FY2019. No major concerns on liquidity are foreseen, given cash and liquid investments of Rs. 42 crore as at September 30, 2018, unutilised overdraft limit of Rs. 15 crore besides unavailed project debt sanctions and minimal requirement of incremental working capital funding. LTHL also has the option of availing top-up loans towards reimbursement of equity funded capex undertaken and under-leveraged properties.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Hotel Industry
Parent/Group Support	Not applicable
Consolidation / Standalone	The rating is based on consolidated financial profile of the company.

About the company

Incorporated in 2002 by Mr. Patanjali Keswani and his friends and associates, 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 31 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 31 operational properties and six properties under development. The total inventory across the operational properties stood at 3,659 rooms as on December 30, 2018 (including LTP, Pune which became operational in December 2018). The 1,235 rooms under implementation 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 September 30, 2018, the Group had a portfolio of 22 properties (1,721 rooms) under management agreements, with another 24 properties (with ~1,863 rooms) under negotiation.

Key financial indicators (Audited)

Consolidated	FY 2017	FY 2018	H1 FY2019
OI (Rs. crore)	412.1	484.3	255.6
PAT (Rs. crore)	-5.1	14.5	8.8
OPBDIT/ OI (%)	28.3%	28.1%	27.7%
RoCE (%)	5.0%	5.8%	6.0%
Total Debt/ TNW + Minority Interest (times)	0.7	0.8	0.8
Total Debt/ OPBDIT (times)	6.9	7.4	7.4
Interest Coverage (times)	1.5	1.7	1.8

OI: Operating Income; PAT: Profit after Tax- including share of profits of associates; 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:

	Instrument	Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating		Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					Jan-19	Jun-18	Apr-18	Jun-18	Apr-18
1	Term Loans	Long-term	99.37	94.28	[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

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership*	Consolidation Approach
Lemon Tree Hotels Limited	**100% (Parent Company)**	Full Consolidation
Begonia Hotels Private Limited	74.11%	Full Consolidation
Carnation Hotels Private Limited	100%	Full Consolidation
Fleur Hotels Private Limited (FHPL)	57.98%	Full Consolidation
Dandelion Hotels Private Limite	100%	Full Consolidation
Lemon Tree Hotel Company Private Limited	100%	Full Consolidation
PSK Resorts & Hotels Private Limited	100%	Full Consolidation
Canary Hotels Private Limited	100%	Full Consolidation
Grey Fox Project Management Company Private Limited	100%	Full Consolidation
Nightingale Hotels Private Limited	57.53%	Full Consolidation
Oriole Dr Fresh Hotels Private Limited	100%	Full Consolidation
Red Fox Hotel Company Private Limited	100%	Full Consolidation
Sukhsagar Complexes Private Limited	100%	Full Consolidation
Manakin Resorts Private Limited (Subsidiary of PSK Resorts & Hotels Private Limited)	100%	Full Consolidation
Meringue Hotels Private Limited (Subsidiary of Dandelion Hotels Private Limited upto September 1, 2017	100%	Full Consolidation
Celsia Hotels Private Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
Inovoa Hotels & Resorts Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
IORA Hotels Private Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
Hyacinth Hotels Private Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
Bandhav Resorts Private Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
Ophrys Hotels Private Limited (Subsidiary of FHPL)	57.98%	Full Consolidation
Valerian Management Services Private Limited (Subsidiary of Grey Fox Project Management Company Private Limited)	100%	Full Consolidation
Mind Leaders Learning India Private Limited	36.56%	Equity Method
Pelican Facilities Management Private Limited (Subsidiary of Mind Leaders Learning India Private Limited)	36.56%	Equity Method
Mezereon Hotels LLP (Capital contribution by Fleur Hotels Private Limited & Celsia Hotels Private Limited)	57.98%	Full Consolidation

**Equity interest % as at March 31, 2018; Source: Annual Report*
Note - ICRA has taken a consolidated view of the parent and its subsidiaries.

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About ICRA Limited:

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