

April 13, 2020

Lemon Tree Hotels Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term Loan	116.00	116.00	[ICRA]A- reaffirmed; Outlook revised to Negative from Stable
Long-term/ Short-term – Fund Based Working Capital	30.00	30.00	[ICRA]A- / [ICRA]A2+ reaffirmed; Outlook revised to Negative from Stable
Total	146.00	146.00	

*Instrument details are provided in Annexure-1

Rationale

ICRA has taken a consolidated view on Lemon Tree Hotels Limited (LTHL), which includes its subsidiaries, step-down subsidiaries and associate companies, while assigning the credit ratings, given the common management and significant operational and financial linkages between them.

The revision in outlook to Negative follows the impact of the novel coronavirus (COVID-19) outbreak on the global travel and tourism industry and is in line with ICRA's negative outlook for the sector. Occupancies across most hotels, barring those corralled into supporting the Government's isolation and containment measure, and those being used for work-from-alternative office spaces have crashed across the country, following the pan India 21-day lockdown announced by the GoI on March 24, 2020. This is in line with the situation of the hospitality industry, globally. ICRA also expects the hospitality industry to have one of the longest periods of recovery, contributed by widespread business slowdown over the next couple of quarters.

Given the discretionary nature of consumer spending (especially on leisure travel), the travel and tourism industry has always been highly susceptible to exogenous shocks like wars, terror attacks, disease outbreaks and meltdowns. COVID-19's impact is expected to be far more severe and broad-based than during previous instances. ICRA expects significant pressure on the revenue-per-available room (revPARs), initially through occupancies, over the next two quarters. While some deferred travel, particularly for business, will eventually come back in following some semblance of normalcy, room nights are essentially perishable commodities.

With sizeable operating leverage and debt-servicing requirements, the sharp contraction in revenues will have a detrimental impact on the industry's ability to service its debt. ICRA will continue to monitor the situation as it evolves in India and globally over the coming weeks/months and take appropriate rating action, wherever required.

For LTHL, the sub-optimal operations at the hotels, due to Covid-19 outbreak, are expected to lead to a sharp reduction in cash accruals and possible losses in the near-term. The occupancy levels had plummeted to below 50% in March 2020, following the travel restrictions imposed by the Government. The company has tied up with various State Governments and Hospitals, to provide rooms to serve as isolation rooms or accommodation for health care professionals. The extent and utilisation of such arrangements and its impact on company's operating metrics and profitability remain a monitorable.

LTHL had moderate debt coverage indicators (interest cover 1.6x as at December 31, 2019) and has estimated interest and repayment obligations of Rs. 220¹ crore in FY2021, to be serviced post the Reserve Bank of India's (RBI's) forbearance period, from June 2020 onwards. Given the significant operating costs and debt servicing requirement, the company has initiated various cost containment measures. Nonetheless, the sharp scale-down in revenues may have a severe impact on the company's credit profile. The extent of weakening of the same would depend upon the pace at which normalcy returns. Going forward, the factor of safety between cash accruals, net of loss funding during the shutdown, available lines of credit and repayment requirements are the key rating monitorable.

Despite the above, ICRA draws comfort from the company's financial flexibility emanating from its healthy asset base and the management's demonstrated track record of raising timely debt against projects and refinancing of high cost debt. Further, ICRA takes cognizance of LTHL's financial flexibility, in terms of better access to capital markets.

The ratings continue to favourably factor in the diversified geographical presence of the Group hotels, well-recognised in-house brands, its comfortable capital structure and extensive experience of the promoter in the hospitality industry. ICRA notes the favourable location of the properties (in prominent business districts with a remunerative catchment) and portfolio expansion through an asset-light business models, viz. leasing of properties and management contracts. ICRA also notes that LTHL reported steady operating performance in 9M FY2020, despite integration of sizable Key's hotel portfolio (w.e.f. November 1, 2019) and launch of new inventory at Mumbai and Kolkata.

LTHL Group is seeking a moratorium on payments from its lenders as part of the COVID-19 - Regulatory Package announced by the RBI on March 27, 2020. Accordingly, some of the scheduled repayments were deferred by the group as at March 31, 2020, in anticipation of formal approval from the lenders. However, despite the missed payment and despite the absence of a formal approval from the lenders allowing for a payment relief, ICRA has not recognized this instance as a Default as of now. This is based on ICRA's expectation that a formal approval for rescheduling the loan would be received soon, as permitted by the RBI as part of the relief measures announced recently. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020. It may however be noted that if the lenders do not approve of the moratorium in due course, ICRA would review the above stance on default recognition.

Key rating drivers and their description

Credit strengths

Well-recognised brands and geographically diversified product portfolio - LTHL is one of India's largest hotel chains, with 78 operational properties (as on December 31, 2019) spread across 46 cities. The company has a well-established and 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 the favourable location of its properties in prominent business and tourist districts supports revenue growth and reduces concentration risk.

Experienced promoters and management team – LTHL is promoted by Mr. Patu Keswani, who has been associated with the hospitality industry for over 30 years. The management team is also experienced with a track record of delivering

¹ The amount may undergo revision depending on regulatory changes.

consistent performance through well-planned refurbishment, professional centralized sales, marketing and disciplined cost control. From two properties in 2004, the Group had expanded its portfolio to 78 properties (owned/leased and managed) under seven brands, as of December 31, 2019.

Steady operating performance in 9M FY2020; albeit near-term revenue visibility to be impacted by COVID-19 outbreak

– LTHL reported a 24% YoY revenue growth in 9M FY2020, led by integration of Key's hotel portfolio (w.e.f. November 1, 2019), ramp-up of new inventory (particularly Mumbai, Pune and Kolkata) and steady performance across other mature properties. On its owned/leased portfolio, occupancy declined marginally to 71.3% in Q3 FY2020 as against 72.8% in the corresponding previous quarter due to Key's portfolio integration (occupancy of ~57%). However, portfolio ARR improved by 4% (all hotels basis) to Rs. 4,644 in the same period. ICRA expects the current pandemic to keep the operating metrics muted in the near-term, and these will remain a monitorable.

Comfortable capital structure backed by regular equity infusion – Healthy equity infusions from private equity players (Warburg Pincus and APG) in the past has helped LTHL maintain a comfortable capital structure (TOL/TNW of ~1.0 time) despite undertaking significant and consistent capex towards portfolio expansion. In FY2020, APG infused Rs. 421 crore (viz. 76% of total purchase consideration) for acquisition of Keys hotel portfolio. The management 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.

Reduced project implementation risk; strategy to expand through management contract route to limit capital requirement and minimise risk – The project implementation risk faced by LTHL stands significantly reduced following the launch of five of the seven projects under implementation in the last 18 months. Furthermore, the company has been expanding its footprint through an asset-light model 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 limited project implementation risk.

Credit challenges

Expected impact of COVID-19 on operating metrics and resulting negative operating leverage - Given the discretionary nature of consumer spending, the travel and tourism industry is particularly susceptible to exogenous shocks like wars, natural disasters, terror attacks and disease outbreaks. Following the recent virus outbreak, ICRA expects significant pressure on industry revPARs, initially through occupancies, over the next two quarters. As hotels have high operating and financial leverage, it renders them highly susceptible to any reduction in revenues. While current liquidity buffer provides some cushion, with sizeable debt-servicing requirements, the ongoing disruption will weaken LTHL's credit metrics.

Financial profile characterised by moderate coverage indicators and low RoCE - Nearly one-third of the company's operational owned/leased inventory was in stabilisation phase as of December 2019 (less than three years since commencement of operations), and is yet to meaningfully start contributing to profitability. Accordingly, the company's RoCE remained low at 7.4% in FY2019. Following the COVID-19 outbreak, while near term capex is likely to be deferred, the decline in profitability would keep the consolidated leverage (TD/ OPBDITA at ~7.1x as on March 31, 2019) elevated. ICRA derives comfort from the management's demonstrated track record of refinancing debt at favourable terms. Focus on network expansion via the management contract route would also limit capex requirement and support growth in returns over the long-term.

Stabilisation risk emanating from sizable nascent stage inventory and Key's portfolio integration - LTHL commenced operations at five properties, with nearly 870 rooms, in the last 18 months. In addition, it also acquired Key's hotel

portfolio of nearly 936 rooms (owned) w.e.f. November 1, 2019, which is also in a gestation phase after being integrated with LTHL. ICRA expects the ongoing pandemic to delay the demand recovery and, therefore, the pace of stabilisation of new inventory.

Vulnerability of revenues to inherent industry cyclicity, 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). Despite black-swan events like the COVID-19 outbreak, the risk to operating revenues is partially mitigated by LTHL's geographically diversified portfolio in prominent business districts, which allows it to withstand any demand vulnerability related to any micro-market.

Liquidity position: Adequate

LTHL's liquidity is expected to remain **Adequate**, evidenced by its cash and liquid investments and undrawn term loans and working capital facilities, as of March 31, 2020. Despite the expectation of muted cash flows from operations in the near-term, due to the COVID-19 pandemic, the liquidity would be sufficient for covering the repayment liabilities and fixed cost over the near-term. While the capex commitments are likely to be deferred, some loss-funding for properties undergoing stabilisation may also be required. Nonetheless, ICRA expects LTHL's large asset base and financial flexibility with its lenders to also support refinancing options and liquidity profile.

Rating sensitivities

Positive triggers – A rating upgrade in the near-term is unlikely, given the negative outlook on the industry due to the severe impact expected from the COVID-19 outbreak on the travel and tourism sector. Nonetheless, sustained improvement in operational metrics such as occupancy levels and RevPAR, following the pandemic, and profitability margins and/or infusion of equity leading to reduction in leverage metrics, could be a trigger for a change in outlook.

Negative triggers – Negative pressure on LTHL's rating could arise for reasons including sustained pressure on earning and profitability due to COVID-19 leading to weakening of debt servicing indicators and liquidity position of the company. Since the company is in its growth phase, with a sizable acquisition of the Key's hotel portfolio undertaken in H2 FY2020, seamless integration of new business with the existing portfolio remains a monitorable. The extent and manner of funding the investment in the co-living space (JV with Warburg) also remains a monitorable factor.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Hotel Industry Consolidation and Rating approach
Parent/Group Support	NA
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of LTHL. As on March 31, 2019, the company had 17 subsidiaries, nine stepdown subsidiaries (under indirect control), three associates, and a limited liability partnership, which are all enlisted in Annexure-2.

About the company

Incorporated in 2002 by Mr. Patanjali Keswani and his friends and associates, LTHL is a publicly listed company that owns and operates hotels under four in-house brands—namely, Aurika (upscale), Lemon Tree Premier (upper mid-scale), Lemon Tree (midscale) and Red Fox (economy). Berggruen Hotels Private Limited, a subsidiary of LTHL as of November 1, 2019, has three brands—Keys Lite (economy), Keys Select (midscale) and Keys Prima (Upper midscale)—catering to different customer segments. LTHL properties operated across 47 cities as on January 31, 2020. In terms of ownership, the promoters (Keswani family) hold ~31% stake in the company, APG (a Dutch pension fund) owns ~15% and the balance is owned by foreign portfolio investors, mutual funds, employees and the public.

LTHL 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. As on January 31, 2020, the Group had 41 owned/leased operational properties, along with two under construction properties. The total owned/leased inventory across its operational properties stood at 5,192 rooms. Further, 748 rooms currently under development are expected to be added by early FY2021.

To facilitate rapid expansion of LTHL's brands across the country, the Group's subsidiary, Carnation Hotels Private Limited, typically enters into management contracts with asset owners. As of January 31, 2020, 2,787 rooms across 38 properties were under management contracts with an additional 1,925 rooms under negotiation.

Key financial indicators (audited)

LTHL Consolidated	FY2018	FY2019	9m FY2020*
Operating Income (Rs. crore)	484.3	549.5	493.3
PAT (Rs. crore)	14.0	55.6	6.0
OPBDIT/OI (%)	28.1%	30.7%	35.4%
RoCE (%)	5.8%	7.4%	-
Total Outside Liabilities/Tangible Net Worth (times)	1.0	1.1	-
Total Debt/OPBDIT (times)	7.4	7.1	-
Interest Coverage (times)	1.7	2.0	1.6
DSCR (times)	1.2	1.3	-

*Published 9M FY2020 results, post Ind-AS 116 adjustment

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: $PBIT / \text{Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress)}$; DSCR: $(PBIT + \text{Mat Credit Entitlements} - \text{Fair Value Gains through P\&L} - \text{Non-cash Extraordinary Gain/Loss}) / (\text{Interest} + \text{Repayments made during the Year})$

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Current Rating (FY2021)					Chronology of Rating History for the past 3 years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as of 29-Feb-20 (Rs. crore)	Date & Rating in 13-Apr-20	Date & Rating in FY2020 [^]			Date & Rating in FY2019*	Date & Rating in FY2018
					27-Nov-19	5-Nov-19	8-Jul-19		
1	Term Loans	Long-term	116.0	109.62	[ICRA]A-(Negative)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-&	[ICRA]A-(Stable)
2	Fund based bank facilities	Long-term and short term	30.0	--	[ICRA]A-(Negative)/[ICRA]A2+	[ICRA]A-(Stable)/[ICRA]A2+	[ICRA]A-(Stable)/[ICRA]A2+	[ICRA]A-&[ICRA]A2+	[ICRA]A-(Stable)/[ICRA]A2+

&= Under watch with developing implications

*Other PRs published in FY2019 included update on material events released on Jan 3, 2019 and Mar 19, 2019. No change in rating outstanding in these PRs.

[^]A PR for update on delay in periodic surveillance was published on Sep 27, 2019 in FY2020.

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	Aug 2019	NA	FY2024	17.70	[ICRA]A-(Negative)
NA	Term Loan-II	Aug 2019	NA	FY2024	16.95	[ICRA]A-(Negative)
NA	Term Loan-III	Apr 2016	NA	FY2026	19.32	[ICRA]A-(Negative)
NA	Term Loan-IV	Apr 2017	NA	FY2025	9.49	[ICRA]A-(Negative)
NA	Term Loan-V	Apr 2015	NA	FY2021	7.23	[ICRA]A-(Negative)
NA	Term Loan-VI	Oct 2019	NA	FY2031	45.00	[ICRA]A-(Negative)
NA	Overdraft limit	NA	NA	NA	30.00	[ICRA]A-(Negative)/A2+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	LTHL Ownership	Consolidation Approach
Lemon Tree Hotels Limited	100.00% (rated entity)	Full Consolidation
Begonia Hotels Private Limited	74.11%	Full Consolidation
Carnation Hotels Private Limited	74.90%	Full Consolidation
Fleur Hotels Private Limited	57.98%	Full Consolidation
Dandelion Hotels Private Limited	100.00%	Full Consolidation
Lemon Tree Hotel Company Private Limited	100.00%	Full Consolidation
PSK Resorts & Hotels Private Limited	100.00%	Full Consolidation
Canary Hotels Private Limited	100.00%	Full Consolidation
Grey Fox Project Management Company Private Limited	100.00%	Full Consolidation
Nightingale Hotels Private Limited	100.00%	Full Consolidation
Oriole Dr Fresh Hotels Private Limited	100.00%	Full Consolidation
Red Fox Hotel Company Private Limited	100.00%	Full Consolidation
Sukhsagar Complexes Private Limited	100.00%	Full Consolidation
Manakin Resorts Private Limited (Subsidiary of PSK Resorts & Hotels Private Limited)	10.00%	Full Consolidation
Meringue Hotels Private Limited	59.48%	Full Consolidation
Poplar Homestead Holdings Private Limited	100.00%	Full Consolidation
Madder Stays Private Limited	100.00%	Full Consolidation
Jessamine Stays Private Limited	100.00%	Full Consolidation
Manakin Resorts Private Limited (Subsidiary of PSK Resorts & Hotels Private Limited)	90.00%	Full Consolidation
Celsia Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	57.98%	Full Consolidation
Inovia Hotels & Resorts Limited (Subsidiary of Fleur Hotels Private Limited)	57.98%	Full Consolidation
IORA Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	59.66%	Full Consolidation
Hyacinth Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	57.98%	Full Consolidation
Bandhav Resorts Private Limited (Subsidiary of Fleur Hotels Private Limited)	57.98%	Full Consolidation
Ophrys Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	57.98%	Full Consolidation
Valerian Management Services Private Limited (Subsidiary of Grey Fox Project Management Company Private Limited)	100.00%	Full Consolidation
Meringue Hotels Private Limited (Subsidiary of Dandelion Hotels Private Limited upto September 1, 2017)	40.52%	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
Hamstede Living Private Limited	30.00%	Equity Method

Company Name	LTHL Ownership	Consolidation Approach
Mezereon Hotels LLP (Capital contribution by Fleur Hotels Private Limited & Celsia Hotels Private Limited)	57.98%	Full consolidation

Source: LTHL annual report FY2019

Note: ICRA has taken a consolidated view of the parent (LTHL), its subsidiaries and associates while assigning the ratings.

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