November 02, 2020

Lemon Tree Hotels Limited: Ratings reaffirmed; outlook continues to be 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	108.78	[ICRA]A- (Negative); reaffirmed
Long-term/ Short -term – Fund Based Working Capital	30.00	30.00	[ICRA]A- (Negative) /[ICRA]A2+; reaffirmed
Long-term/ Short -term – Unallocated	-	7.22	[ICRA]A- (Negative) /[ICRA]A2+; reaffirmed
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 Negative outlook on the long-term rating continues to reflect the likelihood of extensive and extended impact of the Covid-19 pandemic on the global travel and hospitality industry and is in line with ICRA's Negative outlook for the sector. The nationwide lockdowns in April and May 2020, to contain the spread of the virus, were followed by sporadic localised lockdowns, which caused hotels to either remain shut or operated at minimal occupancies in Q1 FY2021. While the easing of restrictions has led to some improvement in Q2 FY2021, discretionary travel (leisure or corporate) would remain muted for a few quarters. Consequently, ICRA expects LTHL to witness a significant fall in the revenues and profits in FY2021. As a result, the company's cash accruals are likely to weaken in the near to medium term.

Nonetheless, ICRA takes cognizance that LTHL raised funds aggregating Rs. 175 crore from its strategic investor APG Asset Management NV (APG, 15% shareholder in LTHL) in Fleur Hotels Private Limited (a 58.24% LTHL subsidiary) in June 2020. In addition, the company had availed the moratorium on debt servicing extended by the RBI for the period of March–August 2020, which helped it in conserving cash amid an uncertain operating environment. These funds, along with undrawn bank lines of Rs. 30.0 crore (as on August 31, 2020), provide a liquidity buffer to the company for meeting any shortfall in debt servicing requirements. LTHL can also tap into the second tranche of funding from APG (Rs. 125 crore on stand-by, subject to the consent of LTHL and APG) or access capital markets (in-principal approval for the Rs. 150-crore fund raise taken from the Board), if required. Despite a 71% YoY decline in revenues, the company reported a marginal operating profit in Q1 FY2021, backed by timely and stringent cost containment measures. This prevented any requirement for loss funding and augurs well for its ability to effectively manage costs, to match the reduced revenues, in the near term. Furthermore, the company is expected to incur a minimal project capex in FY2021. Hence, LTHL's overall liquidity position is expected to be adequate for the next few quarters.

The rating reaffirmation continues to favourably factor in the diversified geographical presence of the LTHL hotels, well-recognised in-house brands, 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. LTHL reported a steady operating performance in FY2020, despite integration of the sizeable Key's hotel portfolio (w.e.f. November 1, 2019) and launch of new inventory at Mumbai, Udaipur, and Kolkata. In Q1 FY2021, despite the tough operating environment due to the restrictions placed to prevent the spread of Covid-19, the company was able to report a marginal operating profit. This was supported by – a) its ability to keep nearly 70% of its operational inventory open, by corralling business from Government (quarantine centres), repatriation/*Vande Bharat* traffic, hospital chains (for asymptomatic patients) and corporates (business continuity operations) and b) timely and systematic cost containment measures to offs-set the impact of lower revenues. While the pandemic situation continues to evolve, the extent of recovery in operations in H2 FY2021, will be a key monitorable.

The ratings, however, remain constrained due to LTHL's moderate debt coverage indictors (DSCR of 1.1x and TD/OPBDITA of 8.5[1] times as on March 31, 2020) and muted returns on capital employed (ROCE of 6.2% in FY2020). These are expected to deteriorate further in the near to medium term, as the pandemic would likely cause sharp decline in revenues and profitability in FY2021 followed by a gradual recovery to pre-Covid levels over the next 2-3 years. Further, while project implementation risk has reduced for LTHL in the past two years, it has a significant (30%) nascent stage inventory (hotels operational for <3 years as on March 31, 2020). With looming demand uncertainties in the near term, these may take longer to stabilise and start meaningfully contributing to the profits. Also, the company has significant projected debt-funded capex on its Mumbai Airport project over the next 2-2.5 years, which may increase its financial leverage. While the project debt is yet to be tied up for the same, ICRA does not anticipate any delays in financing tie-up given the favourable location and almost entire project equity having been invested upfront. 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.

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 80 operational properties (as on July 31, 2020) spread across 48 cities and benefits from a robust distribution system, loyalty programmes and corporate relationships. The company has well-established and recognised mid-scale (Lemon Tree) and economy segment (Red Fox) brands and with successful launch of upscale brand – Aurika and acquisition of Keys brands in FY2020, it has further diversified and consolidated its presence across price points. This diversified presence reduces the vulnerability of the Group's revenues to cyclical

[1]*Total Debt (TD) also included operating lease liabilities of Rs. 463 crore as on March 31, 2020*

downturns to some extent. 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. An experienced management team with a track record of delivering consistent performance through well-planned refurbishment, professional centralised sales, marketing, and disciplined cost control is a positive. From two properties in 2004, the Group had expanded its portfolio to 80 properties (owned/leased and managed) under seven brands, as of July 31, 2020.

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+ Minority interest of 1.4 times as on March 31, 2020 and ~1.0 in previous years) despite undertaking significant and consistent capex towards portfolio expansion. After funding the majority of the Keys' hotel portfolio acquisition in FY2020, APG has already infused Rs. 175 crore in June 2020 with the commitment to infuse further Rs. 125 crore, if required, subject to the consent of LTHL and APG. 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 two years. Furthermore, the company has been expanding its footprint through an asset-light model that involves leasing of properties or entering management contract with property owners. These models are expected to provide long-term operational benefits to LTHL, as properties can be quickly put into operation with minimal (or nil) capex and limited project implementation risk.

Credit challenges

Sharp decline in revenues and profits due to extensive impact of Covid-19 over the near term - 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 few quarters. As hotels have high operating and financial leverage, it renders them highly susceptible to any reduction in revenues. Nonetheless, 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 specific micro-markets. The anticipated benefits from expansion of portfolio under management contract route and the pace of flow-through to profitability are also likely to be more gradual than previously anticipated. While the current liquidity buffer provides some cushion, with sizeable debt-servicing requirements, the ongoing disruption will weaken LTHL's credit metrics.

Expectation of moderation in coverage indicators and RoCE - LTHL had moderate debt coverage indicators, evidenced by DSCR of 1.1 time and TD/OPBDITA of 8.5 times as on March 31, 2020 on a consolidated debt of Rs.

2,017 crore as of March 31, 2020[2]. It has principal repayment obligations of approximately Rs. 180 crore, cumulatively over FY2021 and FY2022. Following the Covid-19 pandemic, while any major debt-funded capex is likely to be deferred, the decline in profitability would lead to moderation in debt coverage indices in FY2021 followed by a gradual recovery. Further, nearly 30% of the company's operational owned/leased inventory was at a nascent stage as of March 31, 2020 (less than three years since commencement of its operations) and is yet to meaningfully start contributing to profitability, leading to muted RoCE of 6.2% in FY2020. The same is expected to deteriorate in the near term as the nascent properties will take longer to stabilise. Notwithstanding the above, 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 sizeable 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 and flow-through to the profitability emanating from the same.

Liquidity position: Adequate

LTHL's liquidity is expected to remain Adequate, supported by the equity infusion of Rs. 175 crore by APG in June 2020, cash and liquid investments on the books and undrawn bank facilities. Despite the severe impact of Covid-19 on the demand in Q1 FY2021, the company reported a marginal operating profit, which averted any loss in funding requirements. The six-month moratorium on debt servicing (March-Aug 2020), as permitted by the RBI, also helped in conserving liquidity. While the operations are expected to remain adversely impacted in the near-term due to the pandemic, the liquidity would be sufficient in covering the repayment liabilities in the near term. LTHL also has stand-by funds of up to Rs. 125 crore which it can draw from APG at short notice (subject to the consent of LTHL and APG), in addition to accessing the capital markets (in-principal Board approval for raising up to Rs. 150 crore in place). ICRA expects LTHL's large asset base, strategic partnership, and financial flexibility with its lenders to continue supporting its 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 of the pandemic on the hospitality sector. Nonetheless, a sustained improvement in operational metrices and profitability, following the pandemic, and/or timely and adequate infusion of equity funds leading to improvement in liquidity and leverage metrics, could be a trigger for a change in outlook.

Negative triggers – Negative pressure on LTHL's rating could arise due to sustained pressure on its earning and profitability due to COVID-19 and any delay in raising equity funds, leading to weakening in its debt servicing indicators and liquidity position.

[2] *TD included operating lease liabilities of Rs. 463 crore as on Mar 31, 2020*

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, 2020, the company had 16 subsidiaries, nine stepdown subsidiaries (under indirect control), four associates, and a limited liability partnership, which are all enlisted in Annexure-2.

About the company

Incorporated in the year 2002 by Mr. Patanjali Keswani and his friends and associates, Lemon Tree Hotels Limited (LTHL) is a publicly listed company that owns and operates 80 hotels with 8,006 rooms under seven brands across 48 cities in India and abroad. The company's portfolio spans the upscale, midscale and economy segment including brands like - Aurika (Upscale), Lemon Tree Premier and Keys Prima (upper mid-scale), Lemon Tree and Keys Select (midscale), Red Fox and Keys Lite (economy). In terms of ownership, ~31% stake in the company is held by the promoters (Keswani family), ~15% by APG (a Netherlands-based pension fund) and the balance is owned by foreign portfolio investors, mutual funds, employees and public.

The company designs, develops, and manages properties directly or under its subsidiaries (collectively referred to as the Lemon Tree group). While most of the properties in the portfolio are owned by the company directly or through its subsidiaries, a few are operated on a long-term lease basis. As on July 31, 2020, the Group had 41 owned and leased operational properties and two properties in the pipeline. The total owned/leased inventory across the operational properties stood at 5,192 rooms. Further, 748 rooms were under development and are expected to be added over the next three to four years.

With a view to facilitating 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 July 31, 2020, 2,814 rooms across 39 properties were under management contracts with additional 2,011 rooms under negotiation.

Key financial indicators (audited)

LTHL Consolidated	FY2019	FY2020
Operating Income (Rs. crore)	549.5	669.4
PAT (Rs. crore)	55.6	(10.4)
OPBDIT/OI (%)	30.7%	35.6%
RoCE (%)	7.4%	6.2%
Total Outside Liabilities/Tangible Net Worth+ Minority Interest (times)	1.1	1.4
Total Debt/OPBDIT (times)	7.1	8.5
Interest Coverage (times)	2.0	1.5
DSCR (times)	1.3	1.1

Source: Company Results; ICRA research

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); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + 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				
			Amount Rated (Rs. crore)	Amount Outstanding as of Aug-31-20 (Rs. crore)	Date & Rating in		Date & Rating in FY2020^			Date & Rating in FY2019	Date & Rating in FY2018
	Instrument	Type			Nov-2-20	Apr-13-20	Nov-27-19	Nov-5-19	Jul-8-19	Mar-19-19 Jan-3-19 Jun-15-18	Apr-27-17
1	Term Loans	Long-term	108.78	108.78	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A-&	[ICRA]A- (Stable)	[ICRA]A- (Stable)
2	Fund based bank facilities	Long-term and short term	30.00	--	[ICRA]A- (Negative)/ [ICRA]A2+	[ICRA]A- (Negative)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A-&/ [ICRA]A2+&	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+
3	Unallocated	Long-term and short term	7.22	--	[ICRA]A- (Negative)/ [ICRA]A2+	-	--	--	--	--	--

&= Under watch with developing implications

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

^A PR for update on delay in periodic surveillance was published on Sep-27-19 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	16.20	[ICRA]A-(Negative)
NA	Term Loan-II	Aug 2019	NA	FY2025	16.20	[ICRA]A-(Negative)
NA	Term Loan-III	Apr 2016	NA	FY2027	18.90	[ICRA]A-(Negative)
NA	Term Loan-IV	Apr 2017	NA	FY2025	9.06	[ICRA]A-(Negative)
NA	Term Loan-V	Apr 2015	NA	FY2021	4.22	[ICRA]A-(Negative)
NA	Term Loan-VI	Oct 2019	NA	FY2031	44.20	[ICRA]A-(Negative)
NA	Overdraft limit	NA	NA	NA	30.00	[ICRA]A-(Negative)/A2+
NA	Unallocated limit	NA	NA	NA	7.22	[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%	Full Consolidation
Begonia Hotels Private Limited	74.11%	Full Consolidation
Carnation Hotels Private Limited	74.90%	Full Consolidation
Fleur Hotels Private Limited	58.24%	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	57.53%	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)	100.00%	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)	58.24%	Full Consolidation
Inovoa Hotels & Resorts Limited (Subsidiary of Fleur Hotels Private Limited)	58.24%	Full Consolidation
IORA Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	60.23%	Full Consolidation
Hyacinth Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	58.24%	Full Consolidation
Bandhav Resorts Private Limited (Subsidiary of Fleur Hotels Private Limited)	58.24%	Full Consolidation
Ophrys Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	58.24%	Full Consolidation
Valerian Management Services Private Limited (Subsidiary of Grey Fox Project Management Company Private Limited)	100.00%	Full Consolidation
Berggruen Hotels Private Limited (Subsidiary of Fleur Hotels Private Limited)	58.24%	Full consolidation
Mind Leaders Learning India Private Limited	36.56%	Equity Method
Pelican Facilities Management Private Limited (Subsidiary of Mind Leaders Learning	36.56%	Equity Method

Company Name	LTHL Ownership	Consolidation Approach
India Private Limited)		
Glendale Marketing Services Private Limited	36.56%	Equity Method
Hamstede Living Private Limited	30.00%	Equity Method
Mezereon Hotels LLP (Capital contribution by Fleur Hotels Private Limited & Celsia Hotels Private Limited)	58.24%	Full consolidation

Source: LTHL annual report FY2020

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

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