Sharekhan by BNP PARIBAS

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Indian Hotels Company Limited

Focus on building asset light business model

Consumer Discretionary | Sharekhan code: INDHOTEL | Company Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 148**	
Price Target: **Rs. 182**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

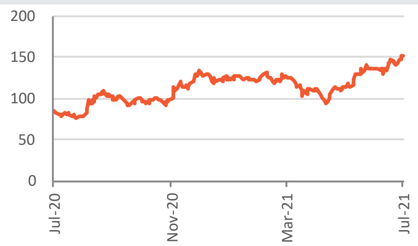
Company details

Market cap:	Rs. 17,601 cr
52-week high/low:	Rs. 158 / 76
NSE volume: (No of shares)	35.8 lakh
BSE code:	500850
NSE code:	INDHOTEL
Free float: (No of shares)	70.5 cr

Shareholding (%)

Promoters	40.8
FII	12.3
DII	28.0
Others	19.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.3	33.8	19.9	80.9
Relative to Sensex	8.5	28.1	12.5	38.3

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on Indian Hotels Company (IHCL) with a revised price target of Rs. 182. Strong room inventory (across pyramid) and a relatively lean balance sheet will help IHCL be a key beneficiary of recovery in the hospitality space.
- IHCL is focusing on turning asset-light by adding rooms through management contracts and scaling up newer initiatives (Qmin & Ama) which can generate higher margins at a minimum capex.
- Company aims to reduce debt to pre-pandemic levels by hiving off non-core assets and generate better return on capital in the medium to long term.
- Stock is currently trading at 25x its FY2023E EV/EBIDTA. Any sustained improvement in occupancies and margins and reduction in debt would further aid re-rating of the stock.

Indian Hotels Company Ltd (IHCL) provided a brief perspective about its future growth avenues and its focus on strengthening its balance sheet by reducing debt and improving return ratios in the medium term. In its 2018 investor meet, the company had aspired for an 800 bps expansion in OPM by CY2022, adding 15 hotels per annum under the management contract route and improving the return ratios by improving the margins and strengthening the balance sheet. The company has managed to achieve 80% of its aspirations with OPM expanding by 534 bps over FY2018-20, actual debt (excluding lease liability) falling, 22/29/17 hotels getting added under the management contract route in FY2019/20/21. The company is focusing on building an asset-light model by adding more rooms under management contracts (targets 50:50 management contract: own room mix) and scaling up new initiatives such as Ama (Homestay) and Qmin (food services) by sweating existing assets to add to incremental profitability and focus on strengthening balance sheet by reducing debt (aims to reduce net debt to pre-pandemic levels of Rs. 1,850 crore from current Rs. 3,110 crore). The company expects the management contract model to contribute 50% to room portfolio (currently 46%) and is eyeing revenues of Rs. 350 crore from management fees revenues (substantial part of it will flow into profitability). New initiatives (including Qmin, Ama and The Chambers) are expected to contribute around Rs. 450 crore over the next two to three years, which clock operating margins ~50%. The company continued to focus on selling off non-core assets to reduce debt on books. A lot of standalone hotels are available at discounted valuations and any inorganic initiatives will be done through the tie up with GIC Singapore. IHCL and GIC have joined hands and would invest around Rs. 4,000 crore in India that would help IHCL's balance sheet to remain lean.

In FY2021, the company saw strong rebound in the business in H2FY2021 with revenues recovering to almost 60% of pre-COVID levels in Q4 with occupancies improving to 60% in the month of February. However, with resurgence of second wave, the occupancies started dropping from March (at 53%) and substantially dropped in April and May when cases peaked and lockdown restrictions became stringent. The cases dropped substantially from June'21 and the management has indicated of pick up in occupancies which stood at around 50% in last few weeks. The reduction in cases, improved mobility and better pace of vaccination will help the room demand to improve in the coming quarters. Once the RevPar crosses threshold limit of 65%, the company is confident of substantial improvement in room economics. Further banquets and restaurant revenues are likely to scale-up substantially in post pandemic era as people will shift to trusted brands for social gatherings/events.

Our Call

View: Retain Buy with revised price target of Rs. 182 - A strong focus on building an asset-light model and recovery in the business environment will help IHCL recover to 80% of pre-COVID levels in FY2023 and clock strong profitability. In FY2022, the company is focusing on keeping its balance sheet lean with no major capital investments. Stock is currently trading at 25x its FY2023E EV/EBIDTA. Any sustained improvement in the business fundamentals and reduction in debt as planned would further re-rate the stock. We maintain a Buy recommendation on the stock with a revised price target of Rs. 182. Among hotels, IHCL is one of the better plays in the unlock theme due to a relatively stable balance sheet, strong room inventory and brand recognition.

Key Risks

Any slow recovery in inbound and outbound tourism industry due to uncertain environment would act as a key risk to earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	4,463	1,575	2,557	3,571
OPM (%)	21.7	-	17.0	25.8
Adjusted PAT	318	-822	-200	198
Adjusted EPS (Rs.)	2.8	-7.8	-1.5	1.9
P/E (x)	48.4	-	-	78.8
P/B (x)	3.4	4.1	4.4	4.2
EV/EBIDTA (x)	22.5	-	49.9	24.7
RoNW (%)	6.2	-	-	4.8
RoCE (%)	7.2	-	1.4	6.6

Source: Company; Sharekhan estimates

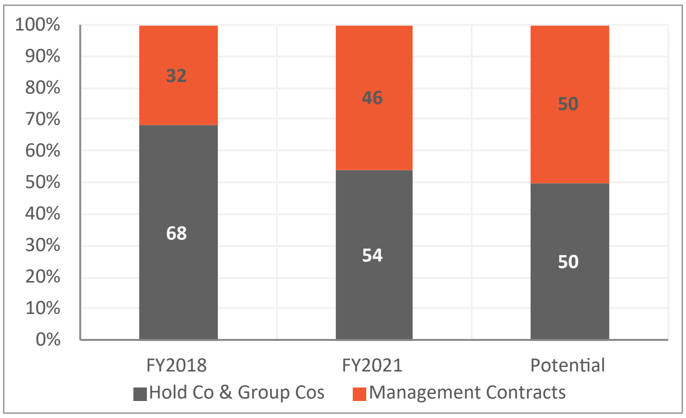
New initiatives have asset-light business model and are margin accretive:

New initiatives (such as Qmin, Ama, The Chambers, etc) are expected to contribute Rs. 450-500 crore or 10% of revenue over the next 2-3 years from 5% currently. Around 60% of incremental revenue growth through these new initiatives would directly flow through EBIDTA, which will help improve overall profitability. New business initiatives such as Qmin operate in a no-capex, high-margin business model. The orders are currently prepared in existing restaurants/hotels or management contract hotels of India. Thus business runs on high operating margins of ~50%. Out of all the food orders booked on Qmin, ~22% is captured by company for hotels outside IHCL and 50% is for hotels under IHCL. So at revenues of Rs. 70 crore, the business is likely to add profit of Rs. 15-20 crore. Qmin's revenue has the potential to reach Rs. 500 crore. Another initiative is Ama (home-stay business) which is also an asset-light initiative wherein IHCL collects 15% as management fees and 3% pass through as marketing expenses. With revenue potential of Rs. 500 crore, Ama is expected to generate profit of Rs. 75 crore. In its new avatar, the chamber has potential to generate revenues of Rs. 150 crore. Currently, there are seven chambers with over 2,200 members. The company is targeting around over 4,000 members.

Management contracts to generate potential fee revenues of Rs. 350 crore:

IHCL has maintained its focus on becoming asset-light by adding more rooms through management contracts. Rooms under the management contract route have gone up to 46% in FY2021 from 32% in FY2018 and the company is targeting a ratio of 50:50.

Portfolio mix of hotel rooms

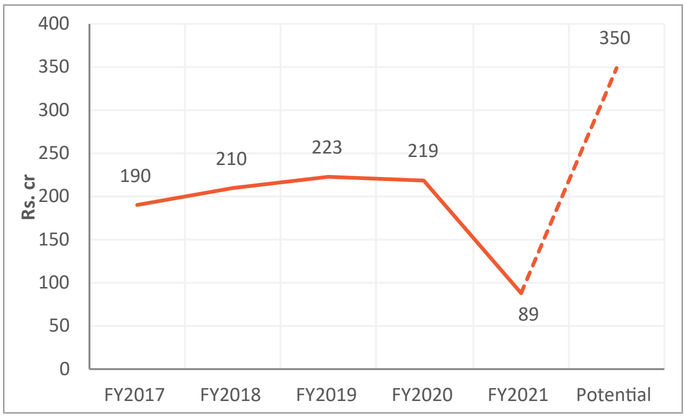


Source: Company, Sharekhan Research

Management fee revenues (part of other operating income) stood at Rs. 219 crore in FY2020, which reduced to Rs. 89 crore in FY2021. With higher rooms coming under the management contract model and an expected improvement in business fundamentals, management fee revenues are expected to rise to Rs. 350 crore. Around 70-80% of fees generated directly flows into EBIDTA, which will help in improving overall profitability.

Capitalizing on business recovery:

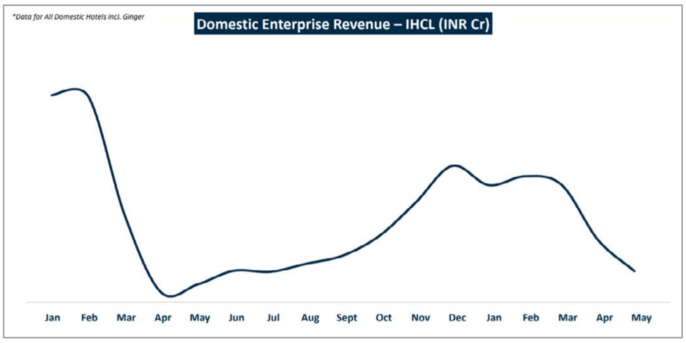
Trend in management fees



Source: Company, Sharekhan Research

In FY2021, the company saw a strong rebound in the business with revenues recovering to almost 60% of pre-COVID levels with occupancies improving to 60% in February. However, with the emergence of the second wave of COVID-19, occupancies started dropping from March (at 53%) and substantially dropped in April and May when cases peaked and lockdown restrictions became stringent. The cases dropped substantially from June-21 and the management has indicated a pick-up in occupancies which stood at around 50% in last few weeks. Staycations in Mumbai, Delhi and Bangalore have gained strong traction. New Delhi has recovered faster after easing of lockdown norms and Mumbai is expected to follow suit. The reduction in cases, improved mobility and better pace of vaccination will help the room demand to improve in coming quarters. In the international market, London occupancies are increasing and currently is higher than Bangalore and other domestic locations. Once the RevPar crosses threshold limit of 65%, the company is confident of a substantial improvement in room economics. Further, banquets and restaurant revenues are likely to scale-up substantially in the post-pandemic era as people will shift to trusted brands for social gatherings/ events. The improvement in occupancies and incremental room revenues would help profitability to improve on back of a higher operating leverage.

Covid-19 impact on IHCL's domestic revenue



Source: Company

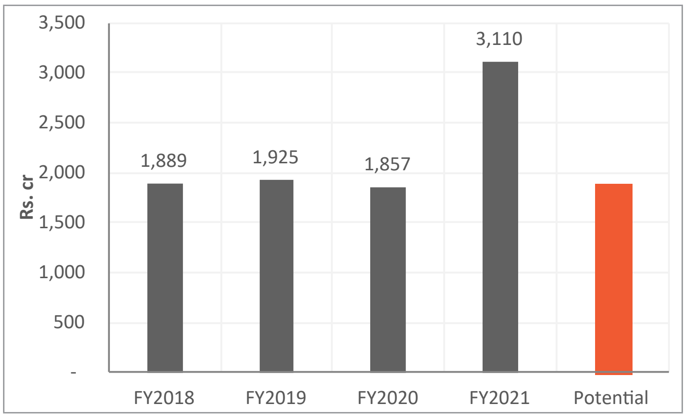
Optimisation of spends aiding cost reduction:

Prudent resource allocation has helped reduction in corporate overheads by 39% in FY2021 to Rs. 213 crore with corporate overhead per hotel coming down to 1.92 in FY2021 from 3.21 in FY2020. On the back of various cost optimisation measures adopted, the total operating cost was down by 45% to Rs. 1,920 crore in FY2021 and fixed expenses per month were down by 28% to Rs. 118 crore in FY2021. In terms of manpower optimisation, the company has substantially reduced the man-to-room ratio in all its brands through redeployment, multitasking, adoption of cluster approach and shared services. IHCL has managed to achieve permanent cost saving of USD 5mn in the US, through various cost saving measures.

Focus on reducing debt:

Net debt stood at Rs. 1,857 crore in FY2020, which increased to Rs. 3,110 crore in FY2021. The company targets to reduce debt to pre-pandemic levels by hiving off some non-core assets. The value of assets reduced substantially in FY2021. However, with a recovery in Q4FY2021, the value of assets has recovered substantially. This will help the company generate better value through sale of assets and reduce debt on books. Lots of M&A opportunities have generated in the current pandemic environment. The company would not go for any M&A activity by raising debt. If any attractive asset comes for sale, the company will acquire it through its tie-up with GIC Singapore.

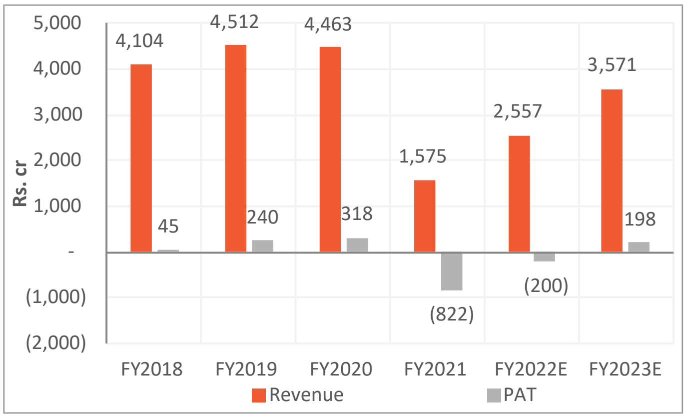
Eyeing debt reduction to pre-COVID level



Source: Company, Sharekhan Research

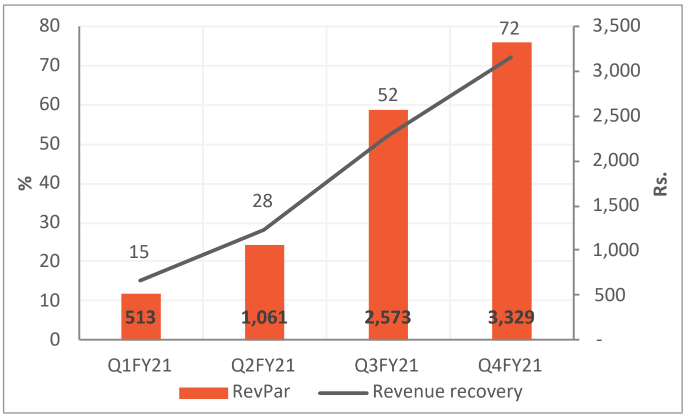
Financials in charts

Revenue and profit to grow in future



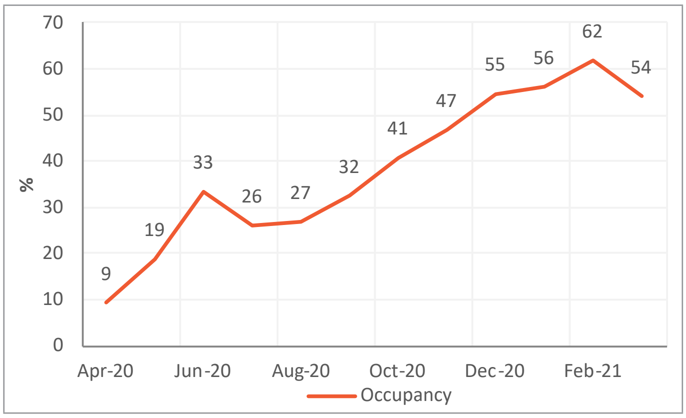
Source: Company, Sharekhan Research

Significant recovery in revenue



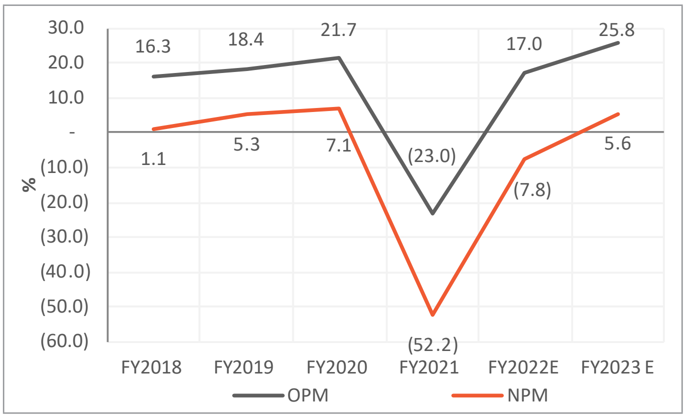
Source: Company, Sharekhan Research

Trend in occupancy



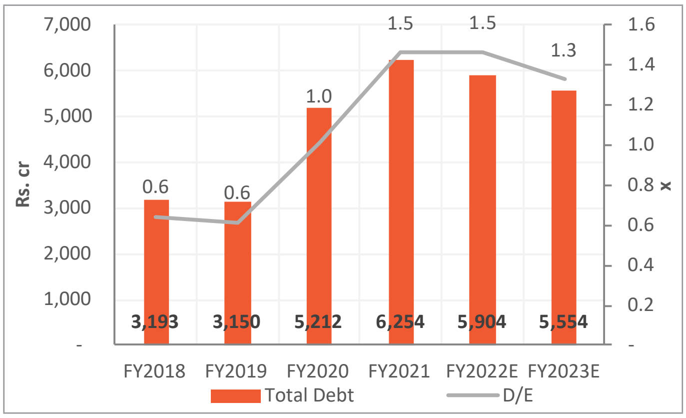
Source: Company, Sharekhan Research

Margins to improve going ahead



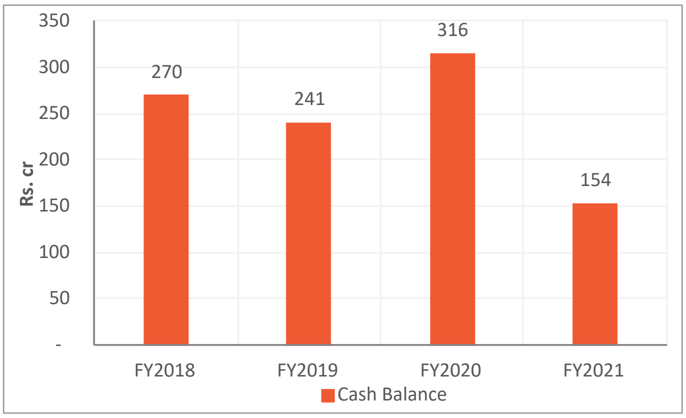
Source: Company, Sharekhan Research

Company to reduce debt



Source: Company, Sharekhan Research

IHCL maintains adequate cash balance



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook - FY2021 was disrupted; recovery expected in FY2023

FY2021 was tough for India hotel industry with some silver-lining in the second half of the year with occupancies improving close to 50% due to improvement in the mobility. As the second wave started some of the markets such Mumbai, Bangalore and Delhi have been badly hit. Thus increase in cases will slow down the recovery, which was anticipated in H2FY2022. However most of the hoteliers are confident of strong recovery once the pandemic pressure eases out (mass vaccination is creating hope for all). On the supply front, financial constraints would delay most hotel projects by a year or two, while some of the standalone hotels are likely to close their operations in the domestic market. However, the risk of rising COVID-19 cases in domestic and international markets will continue to put its toll on occupancies and business performance of hotel companies in the near term.

■ Company outlook - FY2023 business will recover to 80% of pre-COVID levels

In FY2021, IHCL was impacted by the pandemic with consolidated revenues declining by 65% y-o-y and an operating loss of Rs. 368 crore. In the current scenario of a second wave of COVID-19 cases, IHCL's business has continued in less-affected areas in the absence of nationwide lockdowns. With international markets such as US and UK opening gradually, the properties in these regions are expected to witness gradual improvement in performance. We expect business to recover to 60% of FY2020 levels in FY2022 and 78% of FY2020 levels in FY2023. But the cost saving initiatives undertaken in FY2021 will help the operating profit to recover to 100% in FY2023.

■ Valuation - Retain Buy with revised price target of Rs. 182

A strong focus on building an asset-light model and a recovery in the business environment will help IHCL recover to 80% of pre-COVID levels in FY2023 and clock strong profitability. In FY2022, the company is focusing on keeping its balance sheet lean with no major capital investments. Stock is currently trading at 25x its FY2023E EV/EBIDTA. Any sustained improvement in business fundamentals and reduction in debt as planned would further re-rate stock. We maintain a Buy recommendation on stock with a revised price target of Rs. 182. Among hotels, IHCL is one of the better plays in the unlock theme due to a relatively stable balance sheet, strong room inventory and brand recognition.

Peer Comparison

Particulars	EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Lemon tree Hotels	78.6	31.7	19.4	-0.7	2.1	4.9
Indian Hotels Company	-	49.9	24.7	-5.7	1.4	6.6

Source: Sharekhan and consensus estimates

About company

IHCL and its subsidiaries bring together a group of brands and businesses that offer a fusion of warm Indian hospitality and world-class service. Incorporated by the founder of the Tata Group, Jamsetji Tata, the company opened its first hotel - Taj Mahal Palace, in Bombay in 1903, and currently has 221 hotels in its portfolio around the globe, including presence in India, North America, UK, Africa, Middle East, Malaysia, Sri Lanka, Maldives, Bhutan, and Nepal.

Investment theme

The hotel industry's business fundamentals have improved in recent times with room demand outpacing room supply. IHCL is one of the top players in the domestic hotel space with strong room inventory. Management has aspiration to expand its margins by 8% by FY2023 and the company is posting decent margin expansion for the past few quarters. The significant impact on tourism and setback to the industry due to COVID-19 led to FY2021 remaining subdued for IHCL. However, pent-up demand and international properties improvement in performance by posting positive RevPAR growth will help IHCL post faster recovery (likely from H2FY2022). This will also help cashflows to improve and balance sheet to strengthen in the coming years.

Key Risks

- In the backdrop of the economic slowdown, room supply is going ahead of room demand, which will affect overall business fundamentals of the hotel industry and performance of hotel companies.
- Any disruption in the performance of international properties will affect the consolidated performance of IHCL in the coming years.

Additional Data

Key management personnel

N Chandrasekaran	Chairman
Puneet Chhatwal	CEO & Managing Director
Giridhar Sanjeevi	Chief Financial Officer
Beejal Desai	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Reliance Capital Trustee Co Ltd	6.1
2	HDFC Asset Management Co Ltd	6.0
3	SBI Funds Management Pvt Ltd	4.3
4	Franklin Resources Inc	3.6
5	ICICI Prudential Life Insurance Co	2.8
6	ICICI Prudential Asset Management	2.7
7	Government Pension Fund – Global	2.7
8	Norges Bank	2.3
9	Life Insurance Corp of India	1.8
10	HDFC Life Insurance Co Ltd	1.5

Source: Bloomberg (Old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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