

Company Overview

Lemon Tree Hotels is largest mid scale hotel chain by owned rooms in India. It is managed by Mr. Patanjali G. Keswani, who is chairman and managing director of the company and has 30 years of experience in hotel and hospitality industry. The business operations are spread across value chain from owning, leasing, developing, managing and marketing of hotels. It operates in mid priced hotel sector consisting of upper-midscale, midscale and economy hotel segments to cater large middle class population of India. As on 31st January 2018, Hotel portfolio comprises of 19 owned hotels, three owned hotels located on leased or licensed land, five leased hotels and 18 managed hotels, while 28 new hotels are under development stretched across 28 cities.

Objects of the offer:

To achieve the benefits of listing the Equity Shares on the Stock Exchanges and for the sale of up to 185.48 million equity shares by the selling shareholders.

Investment rationale

Increasing Occupancy, Average Daily Rate and Rooms drives revenue growth

Company keeps high service standards which have resulted in higher than average occupancy rates and customer satisfaction. It has delivered robust 18% revenue CAGR over FY2013-2017 led by strong growth in room rental revenues underpinned by increasing occupancy and average daily rate as well as room additions. The owned and leased hotels had an average occupancy rate of 76.8% for the fiscal year 2017 versus 64% for the industry. In mid-scale and economy, occupancy is approx. 78% versus 65% for the industry. It has delivered robust 18% revenue CAGR over FY2013-2017 led by strong growth in room rental revenues underpinned by increasing occupancy and average daily rate as well as room additions. Increase in occupancy has been the main driver of pick-up in room rental revenue growth. This is primarily because of improving industry occupancy as demand for rooms continues to grow at healthy pace of 12.5% even as supply remains constrained at 5%.

Cost control drives operating margin

Lemon Tree's gross operating margins of approx. 50% is much higher compared to approx. 31% for 4 star and approx. 25% for 3 star hotels is due to its high cost efficiency. This is driven by efficient management of employee costs and power costs, which account for 40-55% of the non-F&B operating costs of hotel chains. Moreover, its employee and power cost per room are much lower than that of its peer in the relevant market. Company's aggregate operating costs for owned and leased hotels, as a percentage of total revenue were 58.4% compared to an average of 66.5% for all participating hotels during fiscal 2016, according to the Horwath Report.

High Capex implies inventory to be capital heavy

Improving EBITDA margins have improved operating cash flows of the company. But, continued capex in new room additions implied the company's free cash flow to be remained negative. Company's room inventory growth in the mid scale segment has been one of the highest across the industry. With industry inventory growing at 10% CAGR over FY2017-2021E, Lemon Tree should continue its market share gain from 7.4% in FY2017 to 8.6% in FY2021E. However, the share of capital guzzling owned rooms will remain high at 64% of company's inventory.

Valuation and Outlook

Lemon Tree is largest mid scale hotel chain by owned rooms. It enjoys higher gross operating margins owing to cost efficiency and occupancy. But, net profits have been negative till FY2017 due to high depreciation and interest costs. We believe that higher operating margins are not sustainable given occupancy and cost efficiency has reached at peak levels. Moreover, company's margins are prone to lower pricing power and increase in inflation. Owing to above factors and past results, we believe company has low earning visibility going forward. Moreover, we believe that company is overvalued at 44.20x EV/EBITDA compared to its listed peer Indian Hotels (25.40x), hence we recommend our clients to **Avoid** this issue.

Issue details

Offer period	26th—28th March 2018
Price band	Rs. 54—Rs. 56
Bid lot	265
Listing	NSE & BSE
Issue size (Rs in mn)	10,386.8
Issue size (no. of share in mn)	185
Face value	10

Issue Structure

QIB	50%
Retail	35%
HNI	15%
	Kotak Mahindra Capital
	CLSA India Pvt Ltd.
BRLM	JP Morgan India Pvt. Ltd.
	Yes Securities
Registrar	Karvy Comput- ershare Pvt Ltd

Shareholding Pattern (%)

Particulars	Pre-Issue %	Post-Issue %
Promoter	31.1	31.1
Public	68.9	68.9
Total	100.0%	100.0%

(*Assuming issue subscribed at higher band)



Income Statement (Millions)

Particulars	FY13	FY14	FY15	FY16	FY17
Revenue					
Revenue from operations	2148.2	2217.2	2903.6	3679.5	4119.3
Total revenue	2148.2	2217.2	2903.6	3679.5	4119.3
Expenses					
Purchase of stock-in-trade	0.0	0.0	0.0	0.0	0.0
Material consumed	221.0	244.2	284.4	346.1	353.3
Employee benefit expenses	563.6	646.4	781.8	854.0	968.9
Other expenses	988.8	1093.3	1330.4	1467.7	1633.5
Total Operating expenses	1773.4	1983.8	2396.6	2667.9	2955.7
EBITDA	374.7	233.4	507.1	1011.7	1163.7
Depreciation and amortisation expense	237.4	309.7	516.9	522.6	510.1
Other income	115.0	208.0	133.6	58.4	97.6
EBIT	252.3	131.8	123.8	547.5	751.2
Finance costs	477.8	487.6	724.6	720.2	775.9
Exceptional Item	0.0	0.0	0.0	0.0	0.0
PBT	-225.5	-355.9	-600.8	-172.8	-24.7
Current tax	0.1	18.8	-0.6	12.1	13.7
Deferred Tax charge	-26.8	-46.7	-4.3	97.5	16.0
MAT Credit Entitlement	0.9	65.0	36.4	15.7	17.2
Total tax	-25.8	37.2	31.6	125.2	47.0
Profit for the Period/ Year	-199.7	-393.1	-632.4	-298.0	-71.7
Diluted EPS	-0.3	-0.5	-0.8	-0.4	-0.1

Source: Company, BP Equities Research

Cash Flow Statement (Millions)

Particulars	FY13	FY14	FY15	FY16	FY17
Cash Flow from operating activities	243	28	(510)	680	1,325
Cash flow from investing activities	(3,758)	(1,051)	(1,501)	(1,028)	(2,290)
Cash flow from financing activities	3,509	1,611	1,587	185	1,003
Net increase/(decrease) in cash and cash equivalents	(7)	588	(424)	(162)	38
Cash and cash equivalents at the beginning of the period	116	136	724	300	138
Cash and cash equivalents acquired on amalgamation	26				
Cash and cash equivalents at the end of the period	136	724	300	138	176

Source: Company, BP Equities Research



Balance Sheet (Millions)

Particulars	FY13	FY14	FY15	FY16	FY17
Liabilities					
Share Capital	1,268	1,286	7,764	7,780	7,812
Reserves and surplus	7,111	6,706	338	319	274
Minority Interest	2,094	2,895	4,223	4,277	4,284
Net worth	10,473	10,888	12,325	12,376	12,369
Long term Borrowings	3,706	4,585	4,866	5,237	6,907
Long-Term Provision	5	7	9	12	14
Other Liabilities	124	103	97	227	281
Total liabilities	14,308	15,583	17,297	17,852	19,571
Assets					
Fixed Asstes	11,210	12,993	14,034	14,907	17,692
Non-current investments	0	0	0	0	0
Deferred Tax Assets (Net)			4		
Long Term Loans & Advances	55	106	92	76	109
Other Non-current Assets	2,191	2,739	3,860	4,343	3,481
Total Non-Current Assets	13,456	15,839	17,991	19,326	21,281
Stock-in-Trade	43	47	48	54	49
Trades recievables	148	160	179	245	314
Cash and Bank Balances	136	724	300	176	176
Investments	1,860	384	312	58	63
Short Term Loans & Advances	8	6	8	6	5
Other Current Assets	167	160	123	195	228
Total Current Asset	2,362	1,480	971	733	836
Less:Current Liabilities	1,509	1,736	1,665	2,207	2,547
Net Current Assets	853	(255)	(694)	(1,473)	(1,711)
Total assets	14,308	15,583	17,297	17,852	19,571

Source: Company, BP Equities Research

Key Risks

- ⇒ The hotel industry is highly competitive in nature
- ⇒ The company has very less pricing power since the pricing of the rooms is on demand supply basis.

**Disclaimer Appendix****Analyst (s) holding in the Stock : Nil****Analyst (s) Certification:**

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