Company Flash

24 October 2007 | 6 pages

Hotel Leela Venture (HTLE.BO)

Buy: Strong 2Q, Expect Growth to Accelerate Further

- **Ahead of expectations** — 2QFY08 revenues increased 31% YoY while earnings grew a strong 82%, better than the 36% growth of 1Q and much ahead of expectations. Operating performance was driven by ARR growth of 7% YoY and stable occupancy of 73% in 2Q. But, other income grew sharply on the back of gains (Rs55mn) on forex debt and interest (Rs.90m) on its unutilized FCCBs.
- **Subdued EBITDA margins** — Margins declined 270bps YoY because of a seasonally weak quarter. Other reasons attributed are 1) Bangalore ARRs being lower 11% YoY but expected to pick up, 2) higher staff costs and 3) 30-rooms in Goa under renovation – we expect this to be offset by a better 2H.
- **Better 2HFY08, expected** — We forecast strong operational performance in 2HFY08. This will be driven by 1) increase in tariffs by ~25% w.e.f from Oct'07 and improved occupancies as a result of the upcoming business-tourist season, 2) higher operating leverage from additional rooms in Mumbai and Bangalore and 3) refurbished rooms in Goa to be available from Dec'07.
- **Capex of Rs19.5bn over FY08-11E** – Leela plans to build five hotels at Udaipur, Chennai, Hyderabad, Pune and South Delhi. This will be funded through a mix of internal accruals, debt and FCCBs issued earlier this year.
- **Maintain Buy (1M)** — With the stock trading at 13x Sept'08 P/E at a 13% discount to the sector and below its 2-year P/E band of 16-25x, we see upside potential.

Buy/Medium Risk	**1M**
Price (24 Oct 07)	Rs46.10
Target price	Rs62.00
Expected share price return	34.5%
Expected dividend yield	0.9%
Expected total return	**35.4%**
Market Cap	Rs17,071M US$431M

Price Performance (RIC: HTLE.BO, BB: LELA IN)

Figure 1. Statistical Abstract

Year to Mar 31	FD EPS (Rs)	EPS Gr (%)	P/E (x)	ROE (%)
2006	1.96	73%	23.5	9.2%
2007	1.99	1%	23.1	6.9%
2008E	3.28	65%	14.1	10.4%
2009E	3.64	11%	12.6	10.4%
2010E	3.77	3%	12.2	9.8%

Source: Company Reports & CIR Estimates

Figure 2. 2Q Earnings Summary

	2QFY07	2QFY08	YoY
Net Sales	766.7	1001.4	31%
EBITDA	382.4	473.1	24%
EDITDA Mgn (%)	49.9%	47.2%	
Interest	83.1	75.3	-9%
Other Income	33.8	176.0	nm
Depreciation	82.3	87.6	6%
PBT	250.8	486.2	94%
PAT	220.6	401.2	82%

Source: Company Reports, CIR

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 3. Hotel Leela's 2QFY08 and 1HFY08 Earnings Summary

	2QFY07	2QFY08	YoY	1HFY07	1HFY08	YoY
Net Sales	766.7	1001.4	31%	1575.0	2003.2	27%
EBITDA	382.4	473.1	24%	774.0	963.1	24%
EDITDA Mgn (%)	49.9%	47.2%		49.1%	48.1%	-2%
Interest	83.1	75.3	-9%	161.7	151.9	-6%
Other Income	33.8	176.0	nm	107.3	208.9	95%
Depreciation	82.3	87.6	6%	164.8	174.7	6%
PBT	250.8	486.2	94%	554.8	845.4	52%
PAT	220.6	401.2	82%	442.6	702.8	59%
Extraordinary Items	0.0	0.0		405.8	0	
Pat after Ext	220.6	401.2	82%	848.4	702.8	-17%

Source: Company Reports, Citi Investment Research

Hotel Leela Venture

Company description

Hotel Leela Venture is a well-known hotel chain in India catering primarily to the premium segment. The company operates four hotels (1,114 rooms) under the 'The Leela' brand across India. The company has a marketing alliance with Kempinski for properties in India. Its luxury properties cater to both business and leisure travelers. With rapid growth in room demand, the company plans to expand its presence in the growth cities of Hyderabad, Chennai, Pune and New Delhi through management contracts. It is the flagship company of Leela Group, which holds a 49% stake in Hotel Leela Venture.

Investment strategy

We rate Leela Buy/Medium Risk (1M), with a target price of Rs62 based on 18x Sept 08 P/E. Our positive view on the stock is premised on: 1) Leela's solid 65% earnings growth, vs. 38% for the sector, in FY08E, leveraging on additional rooms operational in Mumbai and Bangalore (ahead of expected supply in mid-2008); and 2) the stock's laggard performance.

Leela's high dependence on the Bangalore market (where ARR growth is peaking) and lack of a presence in key growth markets - are growth limitations. However, with Mumbai refurbishments (133 rooms) complete and Bangalore room expansion (101 rooms) starting in 4QFY07, we see additional rooms and sustained high ARRs driving Leela's outperformance with earnings growth of 65% vs. sector growth of 38% in FY08E. With growth momentum strong due to room additions and the stock currently trading at 13x Sept 08E P/E, at a 13%, discount to sector P/E of 15x and below the stock's two-year historical P/E band of 16-25x, we see upside potential from here.

Valuation

Our target price of Rs62 is based on 18x Sept 08E P/E. Our target multiple places the stock at a premium to sector valuations of 15x. We assign this premium due to Leela's earnings outperformance vs. the sector.

We use P/E as our primary valuation tool, as we think this captures the company's rapid earnings growth potential. While risk of high dependence on

Bangalore and lack of scale remain, current valuations of 13x Sept 08E P/E (at a discount to the sector and below the stock's two-year historical P/E band of 16-25x), we see upside potential from here.

Risks

We rate Leela Medium Risk based on our quantitative risk-rating system, which tracks 260-day stock volatility. Company-specific downside risks include: 1) Any further plans to raise equity for funding some of the company's capex requirements could be detrimental to our target price; 2) Significant supply of rooms in Bangalore ahead of expectations would likely adversely impact our ARR growth and occupancy assumptions; and 3) Any delay in execution of its new hotels in Chennai, Pune, and Hyderabad, which would push back growth assumptions and dampen sentiment on the stock.

Appendix A-1

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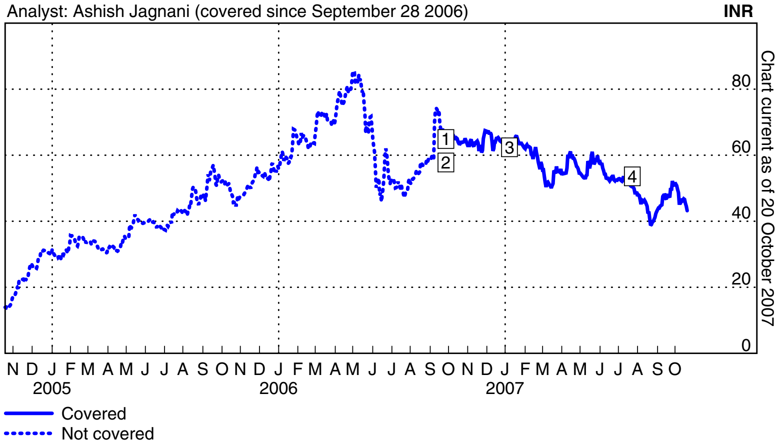
Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since September 28 2006)



#	Date	Rating	Target Price	Closing Price
1:	27 Sep 06	3M	54.00	66.70
2:	27 Sep 06	3M	54.00	66.70
3:	8 Jan 07	3M	*67.00	62.80
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