24 July 2007 | 32 pages

Indian Hotels Sector

More Room for Growth; ARRs to Drive Profitability

- **Strong earnings growth** — We forecast strong FY08 earnings growth of 38% for the Indian hotels sector, after a robust 75% CAGR over the last 2 years. The key growth drivers have been 13% ARR growth, sustained high occupancy of 72% and growth in service offerings — F&B, management contracts and Spas, which have benefited from increased business and leisure travel, and strong demand for rooms.

- **Supply growing, but demand-supply mismatch to persist until FY09E** — New room supply from domestic and international chains will not impact ARRS until FY09E, on our analysis. However, new room supply could increasingly dampen ARRs and occupancies in FY09-10E. We see strong growth for another year, followed by an ARR decline of a 5% CAGR and a lower earnings CAGR of 9% for FY08-10.

- **Most companies in building phase** — Both domestic and international chains are aggressively building capacity in growth markets such as Bangalore, Chennai, Pune and Hyderabad. While this will exert downward pressure on ARRs, additional rooms could partly act as an offset amid solid demand.

- **Subdued performance** — The Indian hotels sector has underperformed the Sensex by 10% over the past 3 month amid concerns about the appreciating rupee and room supply. The sector is trading at the low end of its three-year historical range of 16-20x, which we think is unwarranted given the sector's earnings potential.

- **Top pick IHC, Leela upgraded** — IHC is our top pick on valuation. We upgrade Leela to Buy/Medium Risk from Sell (3M) for its growth potential through room additions, and downgrade EIH to Hold/Low Risk due to moderate upside potential.

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Figure 1. Statistical Snapshot

Year to 31 March	Indian Hotels	EIH Ltd	Hotel Leela
CIR Rating	1L	2L	1M
Market Cap (US$m)	2,120	1,020	466
Price (Rs)	142.00	104.35	50.55
Target Price (Rs)	187	115	62
ETR(%)	32.7	11.6	23.4
PE(x) - FY08E	17.3	19.0	15.4
FY09E	15.1	16.1	13.9
3-Yr EPS CAGR FY07-10E (%)	18	15	24
RoE FY08E (%)	22	18	11

Source: Citigroup Investment Research estimates

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

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Contents

Investment Thesis

Earnings growth still strong

Still room for growth

With the macro prospects still strong, increased business-tourist travel is feeding hotel room demand. We forecast the Indian hotel sector to have another year of strong earnings growth in FY08, of 38%, after a robust 75% CAGR over the last two years. The primary drivers are ARR growth of 13% and sustained high occupancy of 72%. While the appreciating rupee could have a near-term impact on revenues, we believe the sector continues to enjoy pricing power, which, along with operating leverage, should drive earnings growth. Efforts to grow service offerings, F&B outlets, and management contracts will also help growth.

Supply in the pipeline, but demand-supply mismatch until FY09E

Real supply still 12-15 months away

We see new room supply coming from both domestic and international chains that are building aggressively in growth markets such as Bangalore, Chennai, Pune and Hyderabad. But this new supply is unlikely to impact ARRS until FY09E, after which we see supply increasingly dampening ARRs and occupancies. In effect, we see strong earnings growth for another year, followed by an ARR decline of a 5% CAGR and a lower earnings CAGR of 9% for FY08-10E. Growth from room additions should help absorb some of this pressure.

Subdued performance, an opportunity

We see upside potential for sector valuations

The sector has underperformed the Sensex by 10% over the past 3 months due to concerns about the appreciating rupee and potential supply. Acknowledging that earnings could peak in FY08E, we are moderating our target multiples as we roll forward our target multiple benchmarks to September 2008E. The sector is trading at the low end of its three-year historical range of 16-20x, which we think is unwarranted given the sector's earnings potential.

Top pick: Indian Hotels

Indian Hotels: Buy/Low Risk, with target price of Rs187

Indian Hotels is our top pick in the Indian hotels sector, with earnings growth of 34% for FY08E. The stock offers 33% total return based on our target price of Rs187 (21x Sep 2008E P/E). The key potential growth drivers for the stock include: (1) ARR growth of 15% and high occupancy of 73% in FY08E, stronger than those for peers; (2) most of its domestic and key overseas subsidiaries are doing well; and (3) the stock is trading at 16.5x Sep 2008E P/E, on a par with its domestic peers despite its leadership, large room inventory and premium positioning with *Taj*. With the growth fundamentals intact, we expect a re-rating for the stock.

We upgrade Leela to Buy/Medium risk, with a lower target of Rs62

We upgrade Leela to Buy/Medium Risk, with a lower target price of Rs62 (18x Sep 2008E P/E), which offers 23% upside potential. Our view is based on: (1) Leela's potential earnings growth of 65% in FY08E is expected to outperform the sector's, thanks to additional rooms in Mumbai and Bangalore (ahead of supply in mid-2008E); and (2) the stock has underperformed the Sensex by as much as 22% over the past 3 months. While concerns on its high dependence on Bangalore (where ARR growth in peaking) persist, the stock — trading at 15x Sep 2008E P/E — is at a discount to the sector P/E of 16x and is below the low end of its 2-year historical P/E band of 16-25x.

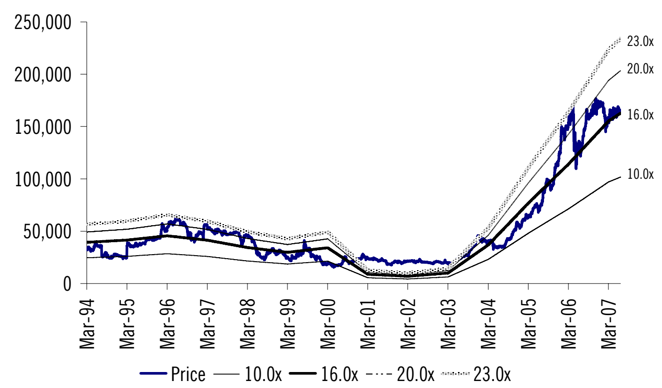
We downgrade EIH to Hold/Low Risk, with target price of Rs115

We downgrade EIH to Hold/Low Risk. Although its earnings growth would remain strong in FY08E, the stock's 13% run-up over the past 4 months leaves only 12% upside based on our target price of Rs115 (19x Sep 2008E P/E). With the stock already trading at 17.5x Sep 2008E PE, at a premium to the sector's 16x, we believe much of the growth is priced in.

Valuations look attractive

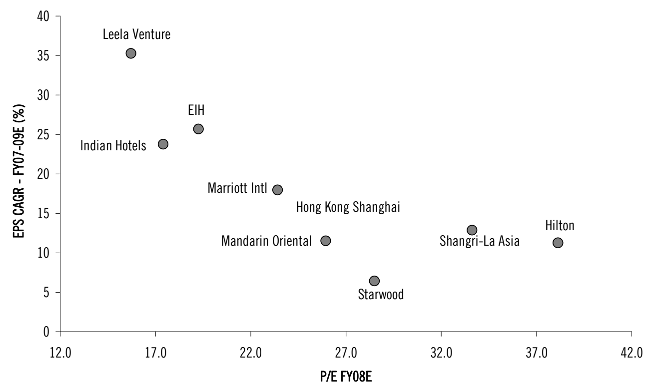
The Indian hotel sector has lagged the Sensex by 10% over the past 3 months, which we attribute to potential supply risks and the potential impact of the appreciating rupee on earnings growth. But with the demand-supply mismatch expected to persist until FY09E, the sector is likely to continue enjoying pricing power, which should drive earnings. Despite recognizing supply risks by moderating our target multiples as we roll forward to Sep 2008E, we still believe the current valuation of 16x Sep 2008E P/E (at the low end of the 3-year historical range of 16-20x) offers upside potential. Regional peers are trading at 30x one-year forward P/Es; we expect the Indian hotels sector to play catch-up as India offers a stronger earnings CAGR of 26% over the next 2 years, vs. regional peer growth of sub-10%, and Indian hotels' asset-light approach improves capital efficiency.

Figure 2. Indian Hotel Sector Rolling One-Year Forward P/E Bands



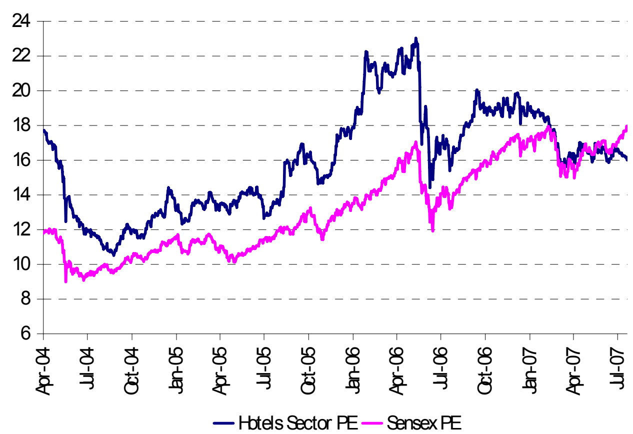
Source: Citigroup Investment Research

Figure 3. Regional Hotel Industry Valuation (2-Year EPS CAGR vs. FY08E PE)



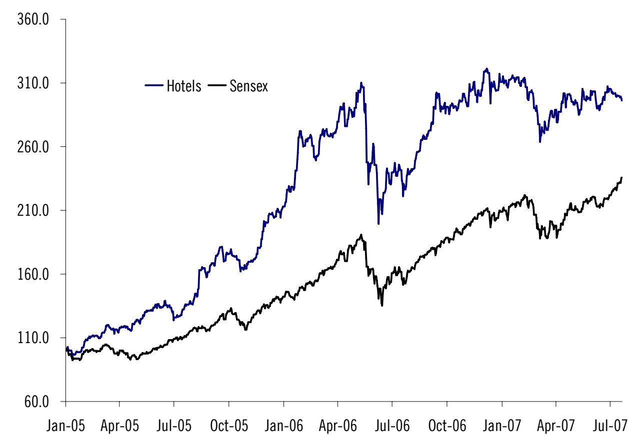
Source: Bloomberg, and Citigroup Investment Research for IHC, EIH, Leela, Hilton

Figure 4. India Hotels Sector P/E vs. Sensex PE



Source: Citigroup Investment Research

Figure 5. Indian Hotel Sector Performance Relative to Sensex



Source: Citigroup Investment Research

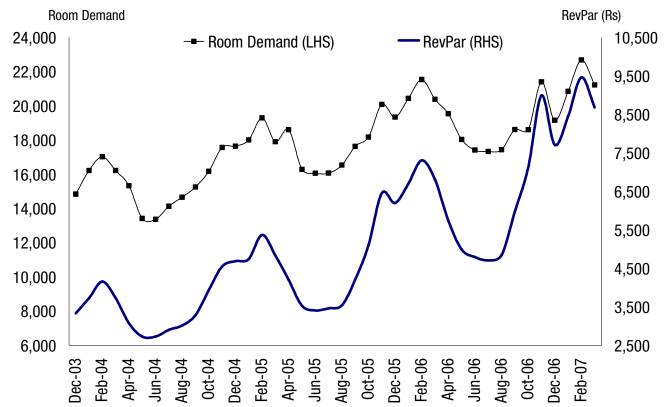
Industry prospects

Operating environment remains strong

Growth in business-tourist traffic to India remains strong

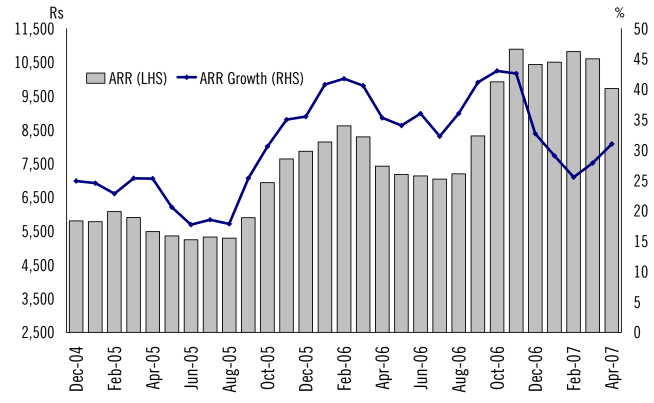
Growth in business-tourist traffic to India remains strong in the double digits. The business confidence index is also at an all-time high with international tourist growth being robust. This provides a conducive operating environment for hotels. The trends for ARR growth and room demand remain encouraging.

Figure 6. Room Demand and RevPar Trend (Units, Rupees)



Source: CRIS INFAC

Figure 7. ARR Growth Trends (Across 10 Indian Cities)



Source: CRIS INFAC

Near-term impact of appreciating rupee

The recent rupee appreciation of 7-9% could have a near-term impact on revenues. Most hotel chains are looking to either increase dollar tariffs or subsequently move to rupee tariffs for domestic as well as international customers. We believe with the sector's strong pricing power, much of this impact would be passed on through ARR hikes.

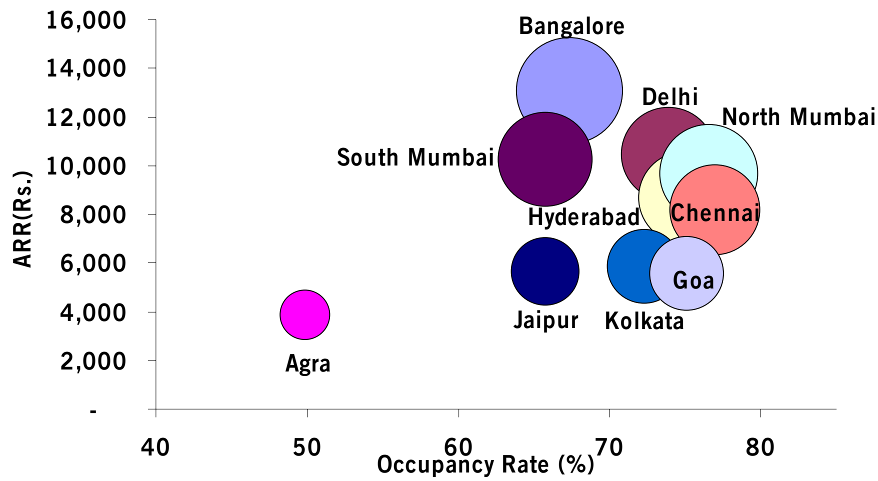
ARR growth moderating but still high; occupancies sustainable

ARR growth to moderate at 13% yoy, with high occupancies sustaining at 72% levels in FY08E

With room demand outpacing supply across markets, ARR growth continues; however, we believe growth will moderate going forward due to a high base. This trend is visible from growth in April-May 2007, when ARRs across 10 cities grew 16%, despite a high base of 33% last year. Occupancies have held at 72%-plus across key growth cities such as Mumbai, Delhi, Bangalore, Chennai, Hyderabad and Pune, while occupancies at leisure destinations were lower due to the off-season. With no significant change in room supply in the near term, we expect this trend to continue.

We forecast 13% ARR growth for FY08 with sustained high occupancy of 72%, after which we see increased supply of rooms dampening ARRs and occupancies in FY09-10E. While the demand-supply gap will ultimately determine ARRs, we believe the risk of ARRs falling further is limited in the near term — barring external factors such as epidemics or international travel warnings.

Figure 8. ARR v/s Occupancy Rate Scatter for Apr-May 2007

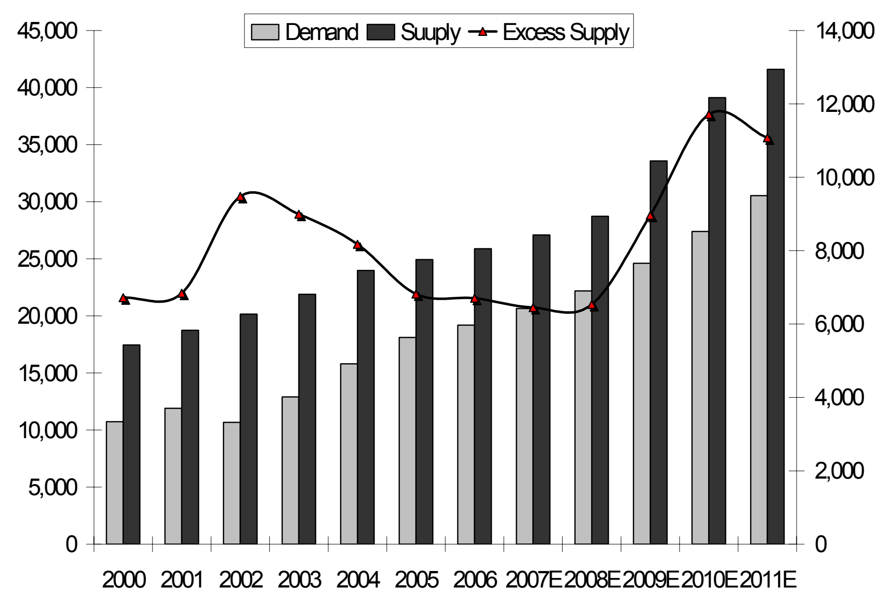


Source: CRIS INFAC and Citigroup Investment Research

Supply in the pipeline, but demand-supply mismatch to persist until FY09E

The trend of room demand outpacing supply, particularly in the premium segment, continues. We see new room supply from domestic as well as international chains, both building aggressively in growth markets such as Bangalore, Chennai, Pune and Hyderabad. But this supply is unlikely to impact until FY09E, after which we see supply of rooms increasingly dampening ARRs and occupancies. Data on aggregate room demand-supply across 10 key Indian cities suggest a similar conclusion.

Figure 9. Aggregate Room Demand-Supply Across 10 Key Indian Cities



Source: CRIS INFAC

Mumbai and Delhi appear best positioned to offer higher ARR growth

Our demand-supply estimates suggest that Mumbai, Delhi and Kolkata are best positioned to benefit from higher ARR growth with sustained occupancy levels of 70%-plus. Bangalore and Chennai would witness increased supply from 2008. While room demand in Chennai and Bangalore remains strong, new room supply could limit tariff increases and affect occupancy levels. Hyderabad and Pune are relatively fast-growing markets with occupancy rates at the 75%-plus level. With most hotels currently building presence in these markets, we expect occupancy rates to stall due to increased supply.

Leisure segment expected to do well

Continued growth in tourist traffic augurs well for the leisure hotel segment. RevPars across most tourist destinations were up 35%-plus for FY07, particularly in key locations such as Goa and Jaipur. Although while Apr-May 2007 is an off-season, RevPars still grew 10%-plus and growth is expected to improve in 2H FY08. We see EIH to be a key beneficiary, with leisure hotels contributing ~15% of FY07-08E room revenues.

Rising land costs and execution delays could push back some supply

Rising land costs in the metros and tier-I cities have been pushing up the project costs of hotels, which have raised questions on the sustainability and feasibility of some of the announced hotel projects. Additionally, the risk of execution and bureaucratic delays, and infrastructure limitations are also expected to push back time lines of some of the projects. This should augur well for the hotel sector, primarily India Hotels and EIH, which operate a large room inventory.

Indian Hotels (IHTL.BO)

Buy/Low Risk	**1L**
Price (23 Jul 07)	Rs142.00
Target price	Rs187.00
Expected share price return	31.7%
Expected dividend yield	1.1%
Expected total return	**32.7%**
Market Cap	Rs85,238M US$2,120M

Price Performance (RIC: IHTL.BO, BB: IH IN)

Buy: Our Top Pick

- Reiterate Buy — Indian Hotel (IHC) is our top sector pick with target price of Rs187 based on 21x Sept '08E P/E (vs. 22x FY08E P/E) to factor in risk of increased room supply; but given scale, stronger earnings growth visibility, IHC's pan-India presence, we expect it to trade at premium to the sector (16x).
- Triggers in place — 1) ARRs should grow 15% with high occupancy of 73% in FY08E, beating its peers; 2) Growth strategy for enhancing room inventory, forays into budget hotels, service offerings – spas, service apartments and F&B outlets is intact; and 3) Focusing on management contracts for growth
- Capex for growth — Plans to add six hotels (1,656 rooms) to the portfolio over FY08-10E – key being in Bangalore, Mumbai and Hyderabad. Besides this, IHC plans to increase number of 'Ginger' hotels to 30 by FY09-10E, up from eight now. Further tied up for management contracts in domestic (2,055 rooms) and international markets (584 rooms); all should be operational by FY08-11E.
- Subs/associates doing well — With a conducive macro environment, all domestic businesses (hotels, air catering) are doing well. Overseas hotels also show positive trends, particularly London; recently acquired The Campton Place, a 110 room hotel in San Francisco for $60m, which reaffirms growth.
- Re-rating potential — The stock has underperformed over the past three months. With earnings CAGR of 18% over FY07-10E, led by strong 35% growth in FY08E, robust business model and stock trading at 16.5x Sept '08E P/E largely at par with sector (16x), we find the stock attractive.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	2,487	4.26	66.8	33.3	4.4	15.5	0.9
2007A	3,703	6.14	44.2	23.1	4.1	18.6	1.1
2008E	4,954	8.22	33.8	17.3	3.4	21.6	1.1
2009E	5,672	9.41	14.5	15.1	2.9	20.8	1.1
2010E	6,100	10.12	7.5	14.0	2.5	19.0	1.1

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	33.3	23.1	17.3	15.1	14.0
EV/EBITDA adjusted (x)	19.2	13.8	11.2	9.9	9.1
P/BV (x)	4.4	4.1	3.4	2.9	2.5
Dividend yield (%)	0.9	1.1	1.1	1.1	1.1
Per Share Data (Rs)					
EPS adjusted	4.26	6.14	8.22	9.41	10.12
EPS reported	4.26	6.14	8.22	9.41	10.12
BVPS	32.41	34.78	41.31	49.04	57.48
DPS	1.30	1.60	1.50	1.50	1.50
Profit & Loss (RsM)					
Net sales	18,373	25,062	30,196	34,696	38,178
Operating expenses	-14,563	-19,464	-22,759	-26,304	-29,275
EBIT	**3,810**	**5,598**	**7,437**	**8,392**	**8,902**
Net interest expense	-1,456	-1,227	-1,455	-1,446	-1,365
Non-operating/exceptionals	1,350	1,731	1,833	1,977	2,059
Pre-tax profit	**3,704**	**6,102**	**7,815**	**8,923**	**9,596**
Tax	-1,073	-2,198	-2,695	-3,067	-3,292
Extraord./Min.Int./Pref.div.	-144	-201	-166	-184	-204
Reported net income	**2,487**	**3,703**	**4,954**	**5,672**	**6,100**
Adjusted earnings	2,487	3,703	4,954	5,672	6,100
Adjusted EBITDA	5,084	7,205	9,239	10,419	11,105
Growth Rates (%)					
Sales	39.9	36.4	20.5	14.9	10.0
EBIT adjusted	72.8	46.9	32.8	12.8	6.1
EBITDA adjusted	53.0	41.7	28.2	12.8	6.6
EPS adjusted	66.8	44.2	33.8	14.5	7.5
Cash Flow (RsM)					
Operating cash flow	**5,231**	**5,918**	**6,156**	**7,454**	**7,972**
Depreciation/amortization	1,274	1,607	1,802	2,027	2,203
Net working capital	622	284	-902	-566	-673
Investing cash flow	**-2,297**	**-11,764**	**-4,564**	**-3,973**	**-5,079**
Capital expenditure	-2,880	-12,677	-5,535	-5,695	-4,971
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-5,257**	**4,653**	**-21**	**-2,313**	**-2,063**
Borrowings	-4,684	5,542	1,059	-1,300	-1,050
Dividends paid	-573	-889	-1,080	-1,013	-1,013
Change in cash	**-2,322**	**-1,193**	**1,571**	**1,168**	**830**
Balance Sheet (RsM)					
Total assets	**42,977**	**52,426**	**57,739**	**61,054**	**65,117**
Cash & cash equivalent	3,899	1,772	2,557	2,392	2,192
Accounts receivable	1,342	2,048	2,316	2,662	2,929
Net fixed assets	24,599	35,526	39,303	42,226	44,748
Total liabilities	**21,646**	**28,701**	**29,908**	**28,380**	**27,151**
Accounts payable	1,997	2,801	3,309	3,802	4,184
Total Debt	15,010	20,551	21,610	20,310	19,260
Shareholders' funds	**21,331**	**23,725**	**27,832**	**32,675**	**37,966**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	27.7	28.7	30.6	30.0	29.1
ROE adjusted	15.5	18.6	21.6	20.8	19.0
ROIC adjusted	9.2	9.6	11.1	11.5	11.3
Net debt to equity	52.1	79.2	68.5	54.8	45.0
Total debt to capital	41.3	46.4	43.7	38.3	33.7

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Key Points

New developments focused on growth

Growth in domestic and overseas markets through new hotels as well as management contracts

Indian Hotels is looking to grow in domestic as well as overseas markets. Its initiatives are: 1) building new hotels across key markets of Bangalore, Mumbai, Hyderabad, 2) Sign management contracts for hotels in Goa, Raipur, Jalandhar, Trivandrum and Nagpur and five service apartments in Pune, Bangalore, Chennai, Delhi and Mumbai; and 3) Acquire controlling stake in ready-to-eat foods brand 'SUMERU', through subsidiary, also inked arrangement with Café Coffee Day for growing the F&B business at its 'Ginger' hotels.

Focus on increasing international presence

Establish Taj as a luxury brand in key gateway international locations which will help in de-risking business model

Key drivers for Indian Hotels' strategy to grow overseas are 1) Establish 'Taj' brand in key gateway international locations in US, Europe, Australia, South Africa, Dubai 2) Position itself as a luxury brand in global markets, similar to the domestic market and 3) De-risk business model, reducing significant dependence on India (74% of FY07 consolidated revenues). In line with this strategy, it acquired the Ritz Carlton, Boston for $170mn in Jan'07 (funded by existing FCCBs of $90mn and debt) and purchased The Campton Place, a 110 room luxury boutique hotel in San Francisco for $60m (funded by 50:50 mix of internal accruals and debt) in Apr'07.

In the long term global positioning will help to manage downturn in domestic market

While this strategy may not fit well in the short term when India is the go to destination and amongst the strongest growth markets, over the long term, positioning in key business/leisure cities across the globe should help it manage the downturn better than in the past. This is not to say the company is substituting capex plans in India for growing overseas; it has aggressive plans of adding 20% additional rooms across key growth cities over next 2-3 years on its existing room inventory of 9901 rooms. This said we are equally cautious on its aggressive approach to acquire assets overseas as recent acquisitions have raised gearing and also had some impact on near-term profitability. Extent of capital commitment towards this strategy will be crucial, in our view.

'Ginger' to target Budget segment

30 'Ginger' hotels planned in the next 2-3 years

The company eyes solid growth opportunities in the 'budget hotel' segment, and has aggressive plans to set up 30 such hotels in phases across the country under the 'Ginger' brand over the next 2-3 years with investments of Rs4bn. These hotels will target the economy and mid-market segment in business/ religious destinations that we see as a big growth opportunity in India, given lack of a large organized 'budget' hotel chain. This venture is routed through 100% subsidiary Roots Corporation, to differentiate it from the Taj brand. The company already has eight hotels operational, plans to have 15 hotels running by Mar '08 – already tied land requirements for 25 sites of the 30 hotels and is in process of negotiations for the rest. While this business is in nascent stages, we believe IHC has an early mover advantage that will strengthen IHC's pan-India presence. This can be leveraged on through higher ARRs and improved occupancies as activity picks up in these key locations.

India Hotels – Some Operational/Upcoming Ginger Hotels in Key Industrial/Leisure locations

Location	Comm/Scheduled Dt.	Key Interests
Bangalore	Jun'04	IT Hub
Haridwar	1QFY07	Religious place of Hindu's
Bhubaneshwar	1QFY07	Place Heritage Temples/Upcoming Steel Centre
Mysore	2QFY07	Industrial/Tourist location
Trivamdrum	2QFY07	Centre in Kerala, increasingly sought Leisure destination
Pune	Nov'06	Industrial/IT centre
Durgapur	4QFY08	Zone for Alloy Industries
Nashik	1QFY08	Developing Manufacturing destination
Agartala, Pondicherry, Baroda, Ludhiana, Goa	Mar'08	Under various stages of construction

Source: Citigroup Investment Research

Capex for growth

Estimated capex of Rs16bn over FY07-FY10E

IHC's aggressive capex plans (for new hotels, a chain of budget hotels, wildlife lodges – over 6,000 rooms on the anvil, renovations and upgrades of existing properties) are progressing as scheduled. We have built in capex of Rs16bn over FY07-10E funded through a mix of internal cash flows and debt. This, in our view, will strengthen IHC's pan-India presence providing it with largest room inventory for taking advantage of strong macro environment in India. We believe this volume growth will insulate it from risk of potential supply that is likely to dampen ARRs and occupancies in FY09-10E.

India Hotels – New Properties/Management Contracts Roll-Out Plan

Within Indian Hotels	No. of Rooms	Expected Comm.
Taj ITPL, Bangalore	199	Jan 2008
Taj Falaknuma Palace, Hyderabad	60	Jul 2008
Taj Santa Cruz, Mumbai	175	Nov 2008
Taj Surya, Coimbatore	150	Dec 2008
Taj Residency, Yeshwantpur, Bangalore	350	Apr 2009
Taj Lake End, Udaipur	80	Apr 2008
Land's End Expansion	142	Apr 2008
Noida	500	NA
Group Expansions		
Taj Mount Road, Chennai	215	Sep 2007
Ginger	2000	Ongoing
Wilderness Lodges	42	Ongoing
Taj Palace, Cape Town	152	Jul 2008
Taj Exotica Resort & Spa, Phuket	79	Apr 2009
Taj, Johannesburg	165	Apr 2009
Management Contracts		
Gateway, Vijaywada	108	Jul 2007
Taj Residency, Trivandrum	134	Dec 2007
Gateway Resort, Bekal (Kerala)	75	Jan 2009
Gateway, Chennai	159	Jan 2009
Portman Residences	700	Apr 2009
Taj Residency, Panjim	154	Apr 2009
Gateway, Raipur	125	Sep 2009
Gateway, Jalandhar	100	Sep 2009
Taj Residency, Nagpur	300	Apr 2008
Gateway, Kolkata	200	NA
Rebak Marina Resort, Langkawi, Malaysia	106	Jul 2007
Taj Tashi, Thimpu, Bhutan	66	Dec 2007
Taj Exotica Palms, Jumeirah, Dubai	262	Dec 2009
Taj Exotica, Doha	150	Jan 2010
Total Room Additions	**6948**	

Source: Company Reports

Revision in estimates

New FY08 revenue estimate higher by 8% but earnings estimate lower by 4%

We are revising our estimates to account for 1) complete impact of consolidation on merger of five subsidiary/associates with the company 2) incorporate the overseas acquisitions of Sydney and recent Taj Boston, US in Jan '07 – however, still need to factor in the The Campton Place, a 110 room hotel acquisition in San Francisco in Apr'07. We have increased our revenue estimates by 8-13% for FY08-09E, largely to factor in the overseas acquisitions. However we have lowered earnings by 4% in FY08E to adjust for higher interest and depreciation costs on account of amalgamation and overseas acquisitions. This was largely triggered by lower consolidated earnings reported in FY07E.

15% ARR growth expected in FY08 with occupancy at 73%

However, despite lower estimates, we forecast strong earnings growth of 34% in FY08E on back of 15% YoY ARR growth (compared to 29% growth in FY07) and sustained high occupancies of 73% similar to FY07. However, with potential supply kicking in across markets, we foresee IHC's ARR's decline by 3% CAGR and occupancies stagnate at 72% levels for FY09-10E. While this is likely to slow growth, we expect volume growth from room additions in FY08-10E, better operating environment for some of its overseas properties, and growth in air-catering business to absorb some of these pressures. Factoring this, better visibility on capex and new management contracts, we expect steady earnings CAGR of 18% for FY07-10E.

India Hotels – Earnings Revision

Year to	FY07			FY08E			FY09E		
31-Mar	New	Old	% Chg	New	Old	% Chg	New	Old	% Chg
Revenue	25,062	24,020	4.3	30,196	28,055	7.6	34,696	30,733	12.9
Net Profit	3,703	4,185	-11.5	4,954	5,067	-2.2	5,673	5,576	1.7
EPS	6.14	7.05	-12.9	8.22	8.54	-3.7	9.41	9.39	0.2

Source: Citigroup Investment Research estimates

India Hotels – Income Statement FY06-FY10E (Rupees in Millions)

Year to 31 March	FY06	FY07	FY08E	FY09E	FY10E
Revenues from IHC	10,843	15,445	19,233	22,295	23,956
Revenues from Subsidiaries	7,531	9,617	10,963	12,401	14,221
Net Sales	**18,373**	**25,062**	**30,196**	**34,696**	**38,178**
Growth (%)	39.9	36.4	20.5	14.9	10.0
F&B Consumed	1,842	1,207	1,506	1,588	1,650
Employee Expenses	4,846	2,782	3,443	4,219	4,808
Power and Fuel	1,059	803	923	1,062	1,179
Other Op Expenses	5,591	5,017	6,143	7,404	8,142
Subsidiary Opr Expenses	14	8,049	8,941	10,004	11,293
Total Operating costs	13,352	17,858	20,957	24,277	27,072
EBITDA	**5,021**	**7,205**	**9,239**	**10,419**	**11,105**
Growth (%)	51.2	43.5	28.2	12.8	6.6
Margin (%)	27.3	28.7	30.6	30.0	29.1
Depreciation	1,274	1,607	1,802	2,027	2,203
Interest Cost	1,456	1,227	1,455	1,446	1,365
Non-op Income	786	954	916	938	892
PBT	3,141	5,325	6,898	7,883	8,429
Share of PBT from Subsidiaries (%)	13	11	14	15	20
Extraordinary Income/(Expenses)	-	-	-	-	-
Less:Prov for Taxes	904	1,965	2,420	2,755	2,942
Less: Minority Interest of Subsidiaries	144	201	166	184	204
Add: Share of and Associates	394	544	642	728	817
Net Income (Reported)	2,487	3,703	4,954	5,672	6,100
Net Profit (recurring)	**2,487**	**3,702.7**	**4,954**	**5,672**	**6,100**
Growth (%)	93.7	48.9	33.8	14.5	7.5

Source: Company Reports and Citigroup Investment Research estimates

India Hotels – Balance Sheet FY06-FY10E (Rupees in Millions)

Year to 31 March	FY06	FY07	FY08E	FY09E	FY10E
Gross fixed assets	32,863	45,838	51,417	56,367	61,092
Less: Depreciation	8,264	10,312	12,114	14,141	16,344
Net fixed assets	24,599	35,526	39,303	42,226	44,748
Investments	5,400	5,143	5,043	5,004	6,250
Cash & bank balances	3,899	1,772	2,557	2,392	2,192
Loans & advances	3,653	4,068	4,725	4,959	5,171
Other Current Assets	1,691	2,497	2,700	3,071	3,354
Total Current assets	9,242	8,336	9,981	10,422	10,717
Current liabilities	3,327	4,590	5,159	5,712	5,534
Provisions	2,057	1,937	1,641	1,107	1,107
Total current liabilities	5,384	6,527	6,800	6,819	6,641
Net current assets	3,858	1,809	3,182	3,603	4,076
Goodwill on Consolidation	3,372	3,141	3,102	3,102	3,102
Total assets	**37,229**	**45,619**	**50,630**	**53,935**	**58,176**
Secured Debt	13,531	17,860	19,110	18,260	17,410
Unsecured Debt	1,479	2,691	2,500	2,050	1,850
Total debt	**15,010**	**20,551**	**21,610**	**20,310**	**19,260**
Equity share capital	584	603	603	603	603
Reserves & surplus	18,318	20,236	24,304	28,964	34,051
Total shareholders' funds	**18,902**	**20,839**	**24,907**	**29,566**	**34,654**
Deft Tax and Others	919	1,470	1,188	950	950
Minority Interest	2,399	2,758	2,925	3,108	3,312
Total liabilities	**37,229**	**45,619**	**50,630**	**53,935**	**58,176**

Source: Company Reports and Citigroup Investment Research estimates

India Hotels – Key Assumptions

Year to 31 March	FY06	FY07	FY08E	FY09E	FY10E
Avg. ARR	7,186	9,260	10,604	10,355	10,009
ARR YoY Gr. (%)	34	29	15	-2	-3
Avg. Occupancy (%)	70	73	73	72	72
Revenue from Subsidiaries (%)	41.0	38.4	36.3	35.7	37.2
F&B / total inc. from ops (%)	37.5	35.2	39.2	39.2	38.8

Source: Company Reports and Citigroup Investment Research estimates

Company description

Indian Hotels (IHC) is the largest hotel operator in India with a presence in the luxury, business and leisure hotel segments. It owns the 'Taj' brand and operates 81 hotels (9,901 rooms) across India and international locations. It is looking to enter the budget hotel segment through its new brand 'Ginger', and make a foray into the adventure business with wildlife lodges. It already operates eight budget hotels, and plans to expand these to 30 in the next 2-3 years with an investment of Rs4bn. The company is also looking to expand overseas through acquisitions/management contracts. Other new revenue streams being explored include serviced apartments, spas and F&B outlets. IHC is the hotel-sector flagship company of Tata Group, which holds a 29% stake.

Investment thesis

IHC is our top pick in India's growing hospitality sector with target of Rs187 based on 21x Sept '08 P/E (vs. 22x FY08E P/E earlier), a premium to the sector average (16x) and increased earnings on sustained high ARR growth. Our target multiple factors in risk of increased room supply starting in FY09E. Favorable macro environment to increase business and leisure travel traffic to India should trigger strong demand for hotel rooms, increase occupancies and average room rates. Leveraging its large room inventories across key growth cities, premium brand positioning with 'Taj' and leadership in domestic markets, we believe IHC is well positioned for growth. Initiatives to de-risk the company's business model and further aid growth and profitability include: 1) Forays into budget hotels; 2) Expansion of service offering to spas, serviced apartments and F&B outlets; 3) Growth through management contracts; and 4) increase presence in overseas markets.

Valuation

Our target price of Rs187 is based on 21x Sept '08E P/E, a premium to average sector valuations of 16x. This implies an expected share price return of 32% over a 12-month horizon. The lower target multiple primarily factors in risk of increased room supply expected starting FY09E. The stock has underperformed the sensex by 11% over the last 3-months on some concerns of appreciating rupee, despite strong earnings growth. However, it trades at 16.5x Sept'08E P/E, towards the lower end of its three-year historical range of 15-22x P/E, largely on par with domestic peers, unwarranted given: 1) IHC's market leadership and advantage of large room inventory; 2) Its premium brand positioning with 'Taj'; and 3) strong business model with reasonable and growing presence in international markets. Factoring this and our expectations of strong 34% earnings growth in FY08E, we foresee a re-rating of current stock valuations.

Risks

Our risk rating system, which tracks historical 260-day share price volatility rates India Hotels Medium Risk. However, we assign a Low Risk rating due to: 1) Sustained growth outlook for the hotel industry given the conducive macro environment; 2) Its leadership position in domestic markets, advantage of scale and strong business model; and 3) Its strong brand positioning and pan-India presence. The main risks to our investment thesis and target price are: 1) Bird-flu hitting India, which would be bad for sentiment; 2) Any delay in the rollout of 'Ginger' hotels and planned room increases; 3) Overpaying for hotel acquisitions in international markets given management's push to expand its brand franchise in global markets; and 4) Any slowdown in economic activity, which could lead to lower hotel room demand.

Buy/Medium Risk	**1M**
from Sell/Medium Risk	
Price (23 Jul 07)	Rs50.55
Target price	Rs62.00
from Rs67.00	
Expected share price return	22.7%
Expected dividend yield	0.8%
Expected total return	**23.4%**
Market Cap	Rs18,719M
	US$466M

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

Hotel Leela Venture (HTLE.BO)

Buy: Room Additions Should Drive Growth

- **Upgrade to Buy (1M)** — We upgrade Leela to 1M on: 1) 65% earnings growth, vs. 38% for the sector, in FY08E with additional rooms operational in Mumbai and Bangalore (ahead of supply in mid-2008); and 2) the stock's 22% underperformance vs. the Sensex over the last three months. Our lower target price of Rs62 is set at 18x Sept 08 P/E, and offers 23% upside potential.

- **Potential catalysts** — With Mumbai refurbishments (133 rooms) complete and Bangalore room expansion (101 rooms) starting in 4QFY07, we see additional rooms and sustained high ARRs leading to improving future earnings growth.

- **We forecast earnings CAGR of 24% over FY07-10E** — This will likely be front loaded, lead by: 1) growth in room additions over FY08E-10E; and 2) income from management contract and leasing of IT Park in Chennai in FY09E-10E. However, ARRs should see a -4% CAGR with occupancy at 67% (vs.74% today) given Leela's dependence on Bangalore (46% of revs) where growth is peaking.

- **Large capex in pipeline, five hotels planned** — Leela has capex of Rs19.5bn for building hotels over FY08E-11E, key locations being: Udaipur, Chennai, Pune, Hyderabad and South Delhi (recently acquired three acres at Rs6.1bn, this is a concern for ROCE, in our view). Per the company, most of this capex will be funded through a mix of internal accruals, debt and recent $100m FCCB issue.

- **Valuations looking increasingly reasonable** — The stock is currently trading at 15x Sept 08E P/E, at discount to sector's 16x. With strong earnings growth momentum and the stock trading at lower end of its two-year historical P/E band of 16-25x, we see upside potential to current valuations.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	724	1.96	72.9	25.7	2.4	9.8	0.8
2007A	837	1.99	1.4	25.4	1.8	8.4	0.9
2008E	1,378	3.28	64.7	15.4	1.6	10.8	0.8
2009E	1,531	3.64	11.1	13.9	1.4	10.9	0.8
2010E	1,584	3.77	3.5	13.4	1.3	10.3	0.8

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	25.7	25.4	15.4	13.9	13.4
EV/EBITDA adjusted (x)	16.9	13.7	9.6	9.0	8.9
P/BV (x)	2.4	1.8	1.6	1.4	1.3
Dividend yield (%)	0.8	0.9	0.8	0.8	0.8
Per Share Data (Rs)					
EPS adjusted	1.96	1.99	3.28	3.64	3.77
EPS reported	1.93	2.95	3.28	3.64	3.77
BVPS	21.31	28.81	31.69	34.94	38.31
DPS	0.40	0.45	0.40	0.40	0.40
Profit & Loss (RsM)					
Net sales	3,270	4,156	5,548	6,716	7,716
Operating expenses	-2,005	-2,601	-3,187	-3,987	-4,732
EBIT	**1,265**	**1,555**	**2,361**	**2,729**	**2,984**
Net interest expense	-330	-347	-548	-700	-760
Non-operating/exceptionals	195	268	308	324	210
Pre-tax profit	**1,130**	**1,476**	**2,121**	**2,353**	**2,434**
Tax	-384	-617	-721	-800	-827
Extraord./Min.Int./Pref.div.	-37	379	-22	-22	-22
Reported net income	**710**	**1,238**	**1,378**	**1,531**	**1,584**
Adjusted earnings	724	837	1,378	1,531	1,584
Adjusted EBITDA	1,590	1,932	2,771	3,319	3,624
Growth Rates (%)					
Sales	27.4	27.1	33.5	21.1	14.9
EBIT adjusted	48.1	22.9	51.9	15.6	9.3
EBITDA adjusted	37.9	21.5	43.5	19.8	9.2
EPS adjusted	72.9	1.4	64.7	11.1	3.5
Cash Flow (RsM)					
Operating cash flow	**621**	**1,667**	**1,728**	**3,746**	**2,601**
Depreciation/amortization	325	377	410	590	640
Net working capital	-413	52	-61	1,625	377
Investing cash flow	**-3,625**	**-1,941**	**-4,650**	**-7,195**	**-3,317**
Capital expenditure	-3,035	-1,950	-4,835	-7,330	-3,553
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**126**	**3,613**	**-1,843**	**1,507**	**-168**
Borrowings	-598	599	-1,675	1,675	0
Dividends paid	-147	-189	-168	-168	-168
Change in cash	**-2,878**	**3,339**	**-4,766**	**-1,942**	**-884**
Balance Sheet (RsM)					
Total assets	**20,189**	**19,989**	**25,766**	**29,791**	**32,539**
Cash & cash equivalent	1,626	445	139	102	82
Accounts receivable	245	291	388	403	386
Net fixed assets	15,455	17,028	21,453	28,194	31,107
Total liabilities	**11,948**	**7,500**	**12,067**	**14,729**	**16,062**
Accounts payable	174	334	417	544	737
Total Debt	10,961	6,440	10,900	12,805	13,550
Shareholders' funds	**8,240**	**12,489**	**13,699**	**15,062**	**16,478**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	48.6	46.5	49.9	49.4	47.0
ROE adjusted	9.8	8.4	10.8	10.9	10.3
ROIC adjusted	5.6	5.2	7.8	7.4	7.3
Net debt to equity	113.3	48.0	78.6	84.3	81.7
Total debt to capital	57.1	34.0	44.3	46.0	45.1

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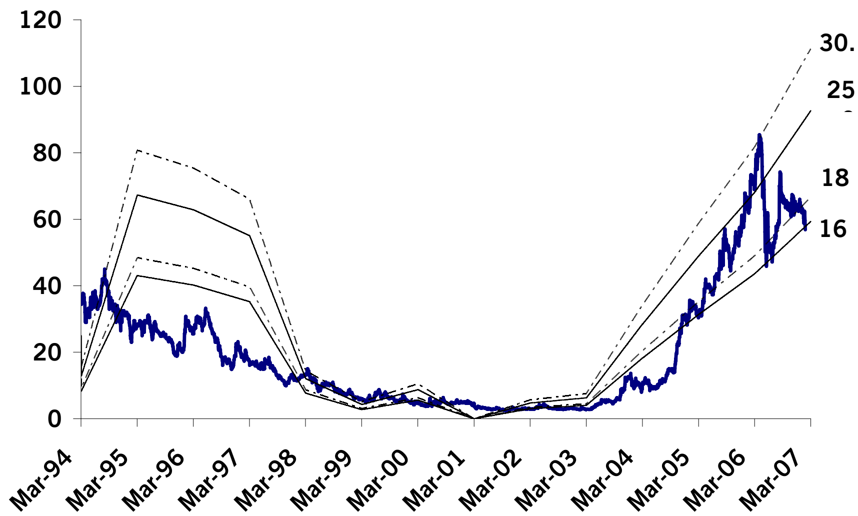
Powered by: dataCentral

Key Points

Reasons to Upgrade

We upgrade our rating on Leela to Buy/Medium Risk (1M) from Sell/Medium Risk (3M), with a lower target price of Rs62 (vs. Rs67 previously) based on 18x Sept 08 P/E (vs. 18x FY08E P/E previously), which implies 23% upside potential. Our upgrade 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 (it has underperformed the Sensex by 22% over the last three months). While concerns on the company's high dependence on Bangalore remain, with growth momentum strong over next one-year due to room additions, and the stock trading at 15x Sept 08E P/E (at discount to sector P/E of 16x and at lower end of the stock's two-year historical P/E band 16-25x), we see upside potential from here.

Hotel Leela One-year Forward PER Band



Source: Bloomberg, Citigroup Investment Research

Management contract and lease income should enhance revenue streams

The company has plans to setting up an IT Park, with around 450,000 sq ft already developed in Chennai, which will be ready by Mar'08 for leasing. We expect this to contribute incremental income of Rs124m and Rs135m in FY09E and FY10E, respectively. In addition, the company also plans to leverage 'The Leela' brand and its experience in managing hotels through management contracts and joint ventures in India and overseas. Its management contract for an upcoming 319-room hotel and 90 service apartments in Gurgaon (on the outskirts of Delhi) are scheduled for operation in 4QFY08E. Revenue from management contracts is currently absent, but is expected to contribute Rs87m per annum from FY09 (per our estimates). The company is exploring new opportunities in Dubai, Abu Dhabi and Jaipur. While these initiatives would aid growth and profitability, we expect benefits from these projects to kick in from FY09. This apart, Leela is also exploring possibilities for setting up a business convention centre in Bangalore, close to its existing hotel.

New hotels in the pipeline

The company has a significant capex plan of Rs19.5bn for the next three years mainly for developing five new properties, an IT Park in Chennai and some room additions in Goa. The properties are likely to be in key locations of Tier I and II cities and the land required has already been acquired, with recent acquisition being three acres in South Delhi at an expensive Rs6.1bn, which has raised some concerns among investors on ROCE in the near term. Per management, most of the capex will be funded through a mix of internal accruals, debt and recently raised $100m FCCB issue (zero coupon with five-year maturity and conversion price of Rs90/share, currently considered as debt in our estimates). With most of the properties expected to become operational in FY09-10, we expect 33% per annum growth from room additions to absorb some pressure of 4% CAGR decline in ARRs that we expect over FY07-10.

Capex Rollout Plan

Properties in pipeline	No. of Rooms	Expected Comm.
Leela, Goa	addition of 29 rooms	mid-2008
Leela Palace, Udaipur	81	early 2008
Leela, Chennai	380	2009-10
IT Park, Chennai	c450,000 sq.ft.	mid-2008
Leela, Delhi	205	2010
Leela, Hyderabad	250	2009-10
Leela, Pune	200	2009-10
Mng contract for Gurgaon	319 rooms + 90 service apts	2HFY08
Total No. of room additions	**1,554**	

Source: Company, Citigroup Investment Research

Revision in earnings and target price

We are reducing our net profit estimates for Hotel Leela by 12% in FY08 to account for lower profitability for Bangalore, given flat ARR growth and lower occupancy due to increasing supply. Further, we have increased our earnings by 13% in FY09E, driven by income from management contract for Gurgaon property and leasing of IT Park, Chennai in FY09E, not factored in earlier.

We expect ARRs to increase by 10% in FY08, on the back of strong room demand with limited supply in Mumbai and Goa with flat growth in Bangalore. However, we forecast a 10% decline in ARRs for FY08-10 and expect occupancy to soften from 74% levels in FY07 to 67% levels by FY10E with significant supply expected in most markets – primarily lead by Leela's high dependence on Bangalore (46% of revs) where growth is peaking. Building this in our estimates we forecast earnings CAGR of 35% over FY07-09E (vs. earlier earnings CAGR of 27%), this growth will likely be front loaded. Further, with more visibility on new properties and factoring impact of growing supply on ARRs and occupancy, we forecast a muted earnings growth of 3.5% for FY10.

With the change in earnings, we have also reduced our target price to Rs62 (vs. Rs67 earlier) as we roll over to Sept 08E earnings (vs. FY08E earlier) based on 18x P/E (no change).

Earnings Revision

Year to	FY07A			FY08E			FY09E		
31-Mar	Actual	Old	% Chg	New	Old	% Chg	New	Old	% Chg
Revenue	4,156	4,705	-11.7	5,548	6,180	-10.2	6,716	6,267	7.2
Net Profit	837	1,145	-26.9	1,378	1,558	-11.5	1,531	1,353	13.1
EPS	1.99	2.73	-26.9	3.28	3.71	-11.5	3.64	3.22	13.1

Source: Company, Citigroup Investment Research estimates

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 (estimated 1,000 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 thesis

We upgrade our rating on Leela to Buy/Medium Risk (1M) from Sell/Medium Risk (3M), with a lower target price of Rs62 (vs. Rs67 previously) based on 18x Sept 08 P/E (vs. 18x FY08E P/E previously), which implies 23% upside potential. Our upgrade 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 (it has underperformed the Sensex by 22% over the last three months).

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 15x Sept 08E P/E, at a 6%, discount to sector P/E of 16x and at the lower end of the stock's two-year historical P/E band of 16-25x, we see upside potential from here.

Valuation

Our revised price target of Rs62 (vs. Rs67 earlier) is based on 18x Sept 08E P/E (vs. FY08E P/E earlier). There is no change to our target multiple, which still places the stock at a premium to sector valuations of 16x. 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, with the stock's 23% underperformance over past three months and valuations currently at 15x Sept 08E P/E (at a discount to the sector and at the lower end of the stock's two-year historical P/E band of 16-25x), we see upside potential from here.

Risk

We rate Leela Medium Risk based on our quantitative risk-rating system, which tracks 260-day stock volatility. Company-specific downside risks include:

- Any further plans to raise equity for funding some of the company's capex requirements could be detrimental to our target price;
- Significant supply of rooms in Bangalore ahead of expectations would likely adversely impact our ARR growth and occupancy assumptions; and
- 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.

Income Statement FY06-10E (Rupees in Millions)

Year to 31 Mar	**FY06**	**FY07**	**FY08E**	**FY09E**	**FY10E**
Total Revenues	**3,270**	**4,155.7**	**5,548**	**6,716**	**7,716**
YoY Growth (%)	27%	27%	34%	21%	15%
EBITDA	**1,590**	**1,932**	**2,771**	**3,319**	**3,624**
Margin (%)	48.6%	46.5%	49.9%	49.4%	47.0%
Depreciation & Amortisation	(325)	(377)	(410)	(590)	(640)
Other income	195	268	308	324	210
EBIT	**1,460**	**1,823**	**2,669**	**3,053**	**3,194**
Interest income(expense)	(330)	(347)	(548)	(700)	(760)
Profit before tax	**1,130**	**1,476**	**2,121**	**2,353**	**2,434**
Tax	(384)	(617)	(721)	(800)	(827)
Profit after tax	**746**	**859**	**1,400**	**1,553**	**1,606**
Pref Divd	(22)	(22)	(22)	(22)	(22)
Recurring PAT	**724**	**837**	**1,378**	**1,531**	**1,584**
Extra-ordinary Items	(14)	401	0	0	0
Reported PAT (after Pref Divd)	**710**	**1,238**	**1,378**	**1,531**	**1,584**

Source: Company Reports and Citigroup Investment Research Estimates

Balance Sheet FY06-10E (Rupees in Millions)

Year to 31 Mar	FY06	FY07	FY08E	FY09E	FY10E
Source of Funds					
Equity Share Capital	737	840	840	840	840
Pref Share Capital	388	388	388	388	388
Reserves	7,116	11,262	12,472	13,834	15,250
Net Worth	7,853	12,102	13,312	14,674	16,090
Def. Tax Liability	363	375	560	695	1,050
Long Term Debt	10,742	6,440	10,900	12,805	13,550
Short Term Debt	219	0	0	0	0
Total Debt	10,961	6,440	10,900	12,805	13,550
Capital Employed	**19,564**	**19,304**	**25,159**	**28,562**	**31,078**
Application of Funds					
Gross Block	16,446	17,901	22,536	28,066	33,419
Depreciation	2,445	2,822	3,232	3,822	4,462
Net Fixed Assets	14,000	15,078	19,303	24,244	28,957
Capital WIP	1,455	1,950	2,150	3,950	2,150
Investments	599	0	1,675	0	0
Inventories	266	332	444	470	540
Sundry Debtors	245	291	388	403	386
Other Current Assets	1,997	1,892	1,666	622	425
Cash and Bank	1,626	445	139	102	82
Current Assets	4,134	2,960	2,637	1,597	1,432
Current Liabilities	(625)	(685)	(607)	(1,229)	(1,462)
Net Current Assets	3,510	2,276	2,030	368	(29)
Total Net Assets	**19,564**	**19,304**	**25,159**	**28,562**	**31,078**

Source: Company Reports and Citigroup Investment Research Estimates

Key Assumptions

Year to 31 Mar	FY06	FY07	FY08E	FY09E	FY10E
Avg. ARR (Rs.)	9,778	11,488	12,644	11,370	10,153
Avg. ARR Gr. (%)	30.3	17.5	10.1	(10.1)	(10.7)
Avg. Occupancy Rate (%)	77	74	71	68	67

Source: Company Reports and Citigroup Investment Research Estimates

Hold/Low Risk	**2L**
from Buy/Low Risk	
Price (23 Jul 07)	Rs104.35
Target price	Rs115.00
from Rs110.00	
Expected share price return	10.2%
Expected dividend yield	1.4%
Expected total return	**11.6%**
Market Cap	Rs41,005M
	US$1,020M

Price Performance (RIC: EIHO.BO, BB: EIH IN)

EIH (EIHO.BO)

Downgrade to Hold: Valuations Limit Upside

- Downgrading to Hold — We downgrade EIH to a Hold/Low Risk (2L). While earnings growth is still strong for FY08E, with stock up 13% over last 4-months, upside appears limited at 11% even as we increase our target to Rs.115 based on lower target multiple of 19x Sept'08E P/E, at 19% premium to sector valuations.

- Earnings CAGR of 15% over FY07-10E, largely front loaded — We forecast strong growth of 33% in FY08E on back of 13% ARR growth and higher occupancy of 69% in FY08E. However with potential supply likely to adversely impact ARRs and occupancy growth in FY09-10E, we expect earnings CAGR to moderate to 15% over FY07-10E.

- Capex in pipeline — 1) Six new hotels in India; 2) hotels in Dubai, Maldives and Cambodia; 3) a luxury train through a JV with Indian Railways and the Govt. of Rajasthan; and 4) a luxury Nile Cruiser in Egypt. Given long gestation period of 2-3 yrs for setting-up new hotels, most of the growth should kick in after FY10E.

- Extraordinary income, a silver lining — The Company owns real estate assets in Pune, Agra, Kolkata, Bhubaneshwar, which it could potentially sell for funding some of its capex plans. This should result in recurring extraordinary income; however given the limited details, we have not built this in our estimates.

- Moderate upside potential — With the stock already trading at 17.5x Sept'08E P/E, at a premium to sector valuations of 16x, we believe much of the 33% earnings growth of FY08E is priced in.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,002	2.55	241.0	40.9	4.2	11.0	1.9
2007A	1,613	4.10	61.0	25.4	3.6	15.3	1.3
2008E	2,153	5.48	33.5	19.0	3.2	17.7	1.4
2009E	2,548	6.48	18.3	16.1	2.7	18.1	1.0
2010E	2,441	6.21	-4.2	16.8	2.4	15.1	1.0

Source: Powered by dataCentral

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	40.9	25.4	19.0	16.1	16.8
EV/EBITDA adjusted (x)	18.0	15.0	12.1	10.4	10.4
P/BV (x)	4.2	3.6	3.2	2.7	2.4
Dividend yield (%)	1.9	1.3	1.4	1.0	1.0
Per Share Data (Rs)					
EPS adjusted	2.55	4.10	5.48	6.48	6.21
EPS reported	4.97	5.10	5.48	6.48	6.21
BVPS	24.86	28.83	33.00	38.49	43.71
DPS	2.00	1.40	1.50	1.00	1.00
Profit & Loss (RsM)					
Net sales	8,135	10,042	12,103	14,292	15,654
Operating expenses	-5,943	-7,411	-8,628	-10,230	-11,661
EBIT	**2,192**	**2,631**	**3,475**	**4,062**	**3,993**
Net interest expense	-793	-773	-834	-854	-875
Non-operating/exceptionals	338	817	658	701	755
Pre-tax profit	**1,737**	**2,675**	**3,299**	**3,909**	**3,874**
Tax	-719	-1,043	-1,104	-1,308	-1,297
Extraord./Min.Int./Pref.div.	935	374	-42	-53	-136
Reported net income	**1,952**	**2,006**	**2,153**	**2,548**	**2,441**
Adjusted earnings	1,002	1,613	2,153	2,548	2,441
Adjusted EBITDA	2,686	3,232	4,094	4,768	4,751
Growth Rates (%)					
Sales	34.1	23.4	20.5	18.1	9.5
EBIT adjusted	161.9	20.0	32.1	16.9	-1.7
EBITDA adjusted	102.4	20.3	26.6	16.5	-0.4
EPS adjusted	241.0	61.0	33.5	18.3	-4.2
Cash Flow (RsM)					
Operating cash flow	**2,799**	**2,379**	**2,970**	**3,005**	**2,933**
Depreciation/amortization	494	602	619	706	758
Net working capital	352	-228	198	-249	-266
Investing cash flow	**-381**	**-3,498**	**-3,325**	**-3,129**	**-1,751**
Capital expenditure	-552	-3,100	-3,325	-2,929	-1,751
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-910**	**622**	**161**	**-486**	**-1,215**
Borrowings	-1,171	863	800	-120	-850
Dividends paid	-786	-550	-589	-393	-393
Change in cash	**1,508**	**-496**	**-195**	**-610**	**-33**
Balance Sheet (RsM)					
Total assets	**22,360**	**24,038**	**26,638**	**28,680**	**30,041**
Cash & cash equivalent	823	885	801	762	654
Accounts receivable	1,037	1,255	1,331	1,429	1,565
Net fixed assets	15,511	18,010	20,716	22,939	23,932
Total liabilities	**12,522**	**12,615**	**13,550**	**13,435**	**12,744**
Accounts payable	1,091	1,090	1,201	1,429	1,635
Total Debt	8,457	9,320	10,120	10,000	9,150
Shareholders' funds	**9,838**	**11,423**	**13,088**	**15,245**	**17,297**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	33.0	32.2	33.8	33.4	30.4
ROE adjusted	11.0	15.3	17.7	18.1	15.1
ROIC adjusted	8.4	8.4	11.1	11.6	10.6
Net debt to equity	77.6	73.8	71.2	60.6	49.1
Total debt to capital	46.2	44.9	43.6	39.6	34.6

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Powered by: dataCentral

Key Points

Downgrade to Hold; most of the growth priced in

We downgrade EIH to a Hold (2L) from a Buy (1L) given limited upside of 11% even as we increase our target to Rs.115 based on a lower target multiple of 19x and rolling over to Sept'08E P/E, at a premium to sector valuations of 16x. Although the growth outlook for the company appears strong in FY08E, with stock's 13% run-up over the past four-month and valuation at 17.5x Sept'08E P/E — a 10% premium to sector valuations — upside appears limited.

While we forecast strong 33% growth in FY08E, with potential supply likely to adversely impact ARRs and occupancy growth in FY09-10E, we expect earnings CAGR to moderate to 15% over FY07-10E. Although the company has aggressive capex plans for new properties, given the long gestation period of 2-3 years to build new hotels, most of the growth from new properties should kick in post FY10E. We believe most of the growth potential is priced in, however likely extraordinary gains from potential unlocking of some real estate assets, remains a silver lining.

Earnings CAGR to moderate to 15% over FY07-10E

While earnings for FY07 were 7% lower than estimate largely due to higher swap loss on interest (Rs.375m) and continuing loss of its subsidiary owning Windflower Hall, Shimla. We forecast strong earnings growth of 33% in FY08E on the back of 13% YoY ARR growth (compared to 32% growth in FY07) and higher occupancy of 69% (vs. 68% in FY07). Further, reduction in swap loss on interest costs to Rs.45mn compared to Rs.375m in FY07, should also contribute towards the FY08E growth and 11% upward revision in FY09E earnings.

Earnings Revision Summary

Year to	FY07A			FY08E			FY09E		
31-Mar	New	Old	% Chg	New	Old	% Chg	New	Old	% Chg
Revenue	10,042	10,216	-1.7	12,103	12,100	0.0	14,292	13,461	6.2
Net Profit	1,613	1,732	-6.9	2,153	2,167	-0.7	2,548	2,298	10.8
EPS	4.10	4.41	-6.9	5.48	5.52	-0.7	6.48	5.85	10.8

Source: Citigroup Investment Research estimates

However, with potential supply kicking in some of EIH's key markets of Delhi and Bangalore, we foresee ARR's decline by 2% CAGR and occupancies stagnate at 69-70% levels for FY08-10E. While, we expect strong growth for other businesses - air-catering, printing press business and car rental business (24% of total income in FY07), with growth for core hotel business likely to slowdown, we expect moderate earnings CAGR of 15% for FY07-10E.

Capex in pipeline, but growth should kick in post FY10E

The company has a significant capex plan for developing new properties, renovating and upgrading existing hotels and F&B outlets over the next 2-3 years. We have currently built in a capex of Rs.8bn over FY07-10E – this would be funded through a mix of internal cash flows, and the unlocking of some real estate assets and debt. However, given the long gestation period for commissioning of new hotels, most of the growth should kick in after FY10E.

Planned capex over FY07-11E

Properties in pipeline	No. of Rooms	Project Status
Trident Hilton, Bandra-Kurla Mumbai	440	open in 2008
The Oberoi Goa and Villas	75 + 19	NA
The Oberoi, Bangalore (Hotel & Service Apts)	225 + 80	NA
The Oberoi, Gurgaon – Mgmt contract	150	2008-2009
The Oberoi, Manesar (Hotel & Service Apts) - Mgmt contract	130 + 40	2008-2009
Rajgarh Palace, Khajuraho	80	2008
Hotel & Service Apts, Dubai	250 + 40	early 2009
Luxury Hotels in Maldives, Angkor Vat (Cambodia)	NA	construction to commence in 2007
A Luxury Nile Cruiser in Egypt	NA	2008
A Luxury Train through JV with Indian Railways & Govt. of Raj.	NA	Regulatory approval in process
Trident Hilton, at upcoming Bangalore International Airport	321	Mgmt contract, target Nov'08
Total No. of Rooms	**c1,800**	

Source: Citigroup Investment Research estimates

Potential for unlocking real estate assets

EIH has a rich portfolio of real estate in Pune, Kolkata, Agra, Bhubneshwar and Vellore a tourist destination in Karnataka. In addition it also has land holdings in Bangalore (8acres), Goa (50 acres) and Bandra, Mumbai for its upcoming hotels – while most of these are unlikely to be unlocked, we see some of the surplus land in excess of the planned development being sold for funding its capex plans. With demand for real estate prices spiraling, we see unlocking of these assets resulting in recurring extraordinary income and incremental cash flows. However, due to the lack of details on land area, acquisition cost and estimated market value for these assets today, it is difficult to incorporate a value, hence not built in our estimates.

EIH

Company description

EIH is the second largest hotel operator in India catering primarily to the premium segment. Through subsidiaries and associates, it operates 20 hotels (estimated 3,000 rooms) under 'The Oberoi' and 'Trident' brands across India – 'The Oberoi' positioned in the luxury segment and 'Trident' targets the high quality mid-price segment. It has a strategic alliance with Hilton, UK (now Hilton Corporation, US) for international marketing of group properties in India, co-branding its Trident Hotels as 'Trident Hilton' and re-branding the Oberoi Towers, Mumbai as Hilton Towers in India. With rapid growth in room demand it plans to expand with new properties in growth cities and through management contracts. It is the flagship of the Oberoi Group, which hold a 46% stake.

Investment thesis

We downgrade EIH to a Hold/Low Risk (2L) from a Buy/Low Risk (1L) given limited upside of 11% even as we increase our target to Rs.115 based on a lower target multiple of 19x Sept'08E P/E, at a premium to sector valuations of 16x. Although the growth outlook for the company appears strong in FY08E, with the stock’s 13% run-up over the past four-months and valuation at 17.5x Sept'08E P/E — a 10% premium to sector valuations — upside appears limited.

While we forecast strong 33% growth in FY08E, with potential supply likely to adversely impact ARRs and occupancy growth in FY09-10E, we expect earnings CAGR to moderate to 15% over FY07-10E. Although the company has aggressive capex plans, most of the growth from new properties should kick in post FY10E. We believe most of the growth potential is priced in, however likely extraordinary gains from potential unlocking of some real estate assets, remains a silver lining.

Valuation

Our increased target price of Rs115 is based on 19x FY08E P/E. We have lowered our target multiple from 20x assigned earlier to factor in the risk of increased supply of rooms coming in starting 2008-09, which would slow ARR growth and dampen occupancy rate. This still places the stock at a premium to sector valuations of 16x Sept'08E P/E, but at a discount to Indian Hotels (21x), offering scale and a stronger business model. The premium to the sector is attributed to: 1) Premium positioning with 'The Oberoi' brand in the luxury hotel segment; and 2) It is the second largest hotel chain in India.

We use P/E as our primary valuation tool, as this captures the rapid earnings growth potential. With the stock trading at 17.5x Sept'08E P/E at a 10% premium to sector valuations of 16x, most of the growth appears priced in, but with growth intact for FY08E and likely extraordinary gains from unlocking of real estate assets, we see moderate upside potential.

Risks

We rate EIH as Low Risk based on our quantitative risk-rating system that measures the stock volatility over a 260-day period.

The main company-specific upside risks include that could prevent the stock from achieving our target price: 1) Strong growth from other operating businesses with early commissioning of new hotel properties could provide upsides; 2) Sale of non-core assets, such as excess land, would result in unlocking of real estate value and increase cash flows for expansion.

The main downside risks facing the company that could impede the stock from reaching our target price include: 1) EIH has little cushion for unforeseen events. Travel warnings, or outbreaks of any epidemic (e.g., SARS in South Asia in FY03) would adversely affect foreign travel and growth leading to lower hotel room demand; 2) Any high-priced acquisitions in the domestic or international markets could constrain cash flows and return ratios.

Income Statement FY06-FY10E (Rupees in Million)

Year to 31 Mar	FY06	FY07	FY08E	FY09E	FY10E
Standalone Revenues	7,564	9,390	11,274	13,341	14,057
Subsidiaries Revenues	571	652	829	951	1,597
Total Revenues	**8,135**	**10,042**	**12,103**	**14,292**	**15,654**
YoY Growth (%)	34%	23%	21%	18%	10%
EBITDA	**2,686**	**3,232**	**4,094**	**4,768**	**4,751**
Margin (%)	33.0%	32.2%	33.8%	33.4%	30.4%
Depreciation & Amortization	(494)	(602)	(619)	(706)	(758)
Other income	292	741	540	557	617
EBIT	**2,483**	**3,372**	**4,015**	**4,619**	**4,610**
Interest income(expense)	(793)	(773)	(834)	(854)	(875)
Profit before tax	**1,690**	**2,600**	**3,181**	**3,765**	**3,735**
Tax	(705)	(1,020)	(1,069)	(1,265)	(1,255)
Profit after tax	**985**	**1,579**	**2,112**	**2,500**	**2,480**
Min Int & Share of Ass	17	34	41	48	(39)
Adj PAT	**1,002**	**1,613**	**2,153**	**2,548**	**2,441**
Extra-ordinary Items	951	393	0	0	0
Reported Net Income	**1,952**	**2,006**	**2,153**	**2,548**	**2,441**

Source: Company Reports and Citigroup Investment Research estimates

Balance Sheet FY06-FY10E (Rupees in Million)

Year to 31 Mar	FY06	FY07	FY08E	FY09E	FY10E
Source of Funds					
Equity Share Capital	524	786	786	786	786
Reserves	9,245	10,543	12,182	14,338	16,389
Net Worth	9,769	11,329	12,968	15,124	17,175
Pref Share Capital					
Def. Tax Liability	1,003	946	905	1,100	1,050
Minority Interest	69	94	120	121	122
Long Term Debt	7,669	8,670	9,370	9,350	8,400
Short Term Debt	788	650	750	650	750
Total Debt	8,457	9,320	10,120	10,000	9,150
Capital Employed	**19,298**	**21,689**	**24,113**	**26,345**	**27,497**
Application of Funds					
Gross Block	17,085	19,503	23,579	27,107	28,857
Depreciation	3,992	4,594	5,213	5,918	6,677
Net Fixed Assets	13,094	14,910	18,366	21,189	22,181
Capital WIP	2,418	3,100	2,350	1,750	1,751
Investments	2,108	1,710	1,710	1,510	1,510
Inventories	481	653	756	858	939
Sundry Debtors	1,037	1,255	1,331	1,429	1,565
Other Current Assets	2,400	1,525	1,323	1,182	1,441
Cash and Bank	823	885	801	762	654
Current Assets	4,740	4,318	4,212	4,231	4,599
Current Liabilities	(3,062)	(2,349)	(2,525)	(2,335)	(2,544)
Net Current Assets	1,678	1,969	1,687	1,896	2,055
Total Net Assets	**19,298**	**21,689**	**24,113**	**26,345**	**27,497**

Source: Company Reports and Citigroup Investment Research estimates

Key Assumptions

Year to 31 Mar	FY06	FY07	FY08E	FY09E	FY10E
Avg. ARR	8,443	11,105	12,515	12,104	11,949
ARR YoY Gr. (%)	26.2	31.5	12.7	(3.3)	(1.3)
Avg. Occupancy (%)	65	68	69	68	70

Source: Company Reports and Citigroup Investment Research estimates

Other Companies

Hilton Hotels Corp (HLT.N - US$44.77; 2M)

Valuation

Our $47.50 target price is based on our view that HLT shares can trade at close to 13.5x our '08 EBITDA estimate. Since 1998, HLT has traded between 6.5x and 11.5x forward EBITDA and at an average valuation of 9x. We believe a multiple just above the high end of the historical range is appropriate, given strong cyclical growth and improvements to HLT's business model versus history. The acquisition of Hilton International in February '06 provided the company with a global platform that was previously lacking. Also, HLT has increased the proportion of its earnings that stem from high margin management and franchise fees versus history.

Risks

We have assigned a Medium Risk rating to HLT shares, which reflects (1) economic risk, (2) moderate balance sheet leverage, (3) solid share liquidity, (4) moderate earnings volatility; (5) disproportionate exposure to the upper-end of the hotel market and (6) travel related security risks. These negative risks could prevent HLT shares from achieving our target price of $47.50. A positive risk is that a higher bid emerges for HLT. Although we view this as unlikely, if it were to occur, HLT shares could exceed our price target of $47.50.

Appendix A-1

Analyst Certification

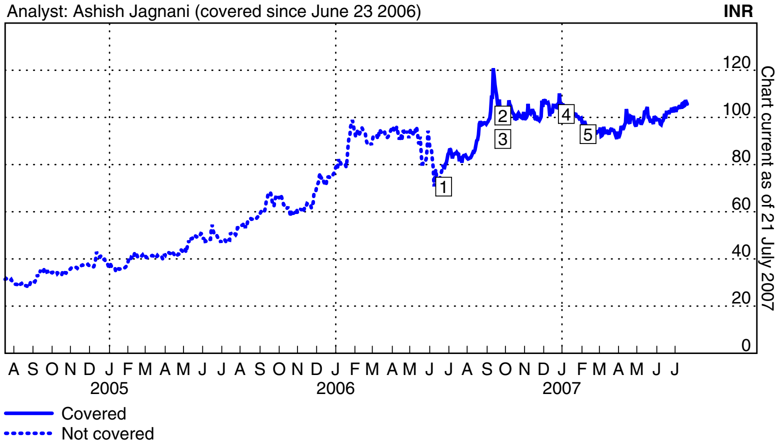
I, Ashish Jagnani, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

EIH (EIHO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since June 23 2006)



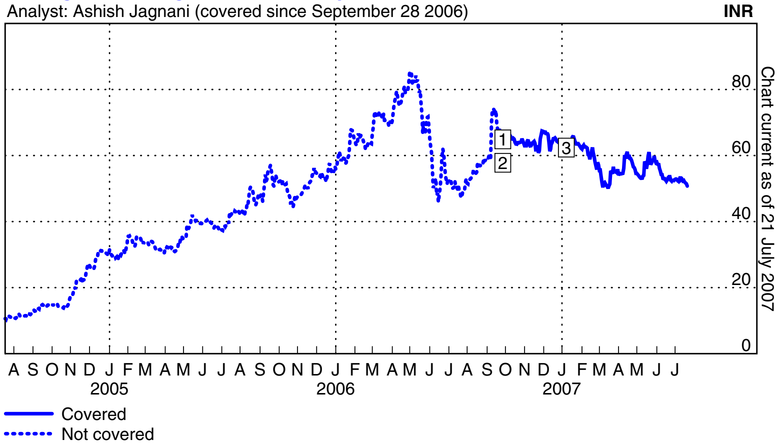
#	Date	Rating	Target Price	Closing Price
1:	23 Jun 06	2L	82.67	78.67
2:	27 Sep 06	2L	*107.00	103.30
3:	27 Sep 06	2L	107.00	103.30
4:	8 Jan 07	2L	*110.00	103.80
5:	12 Feb 07	*1L	110.00	95.05

*Indicates change.

Hotel Leela Venture (HTLE.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since September 28 2006)



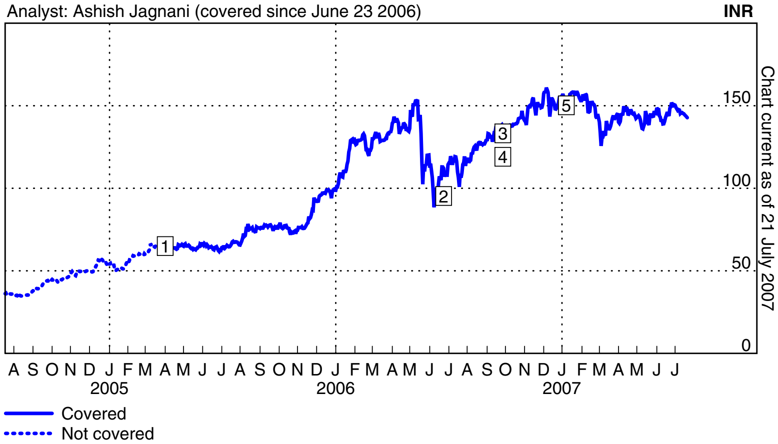
#	Date	Rating	Target Price	Closing Price
1:	27 Sep 06	3M	54.00	66.70
2:	27 Sep 06	3M	54.00	66.70
3:	8 Jan 07	3M	*67.00	62.80

*Indicates change.

Indian Hotels (IHTL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since June 23 2006)



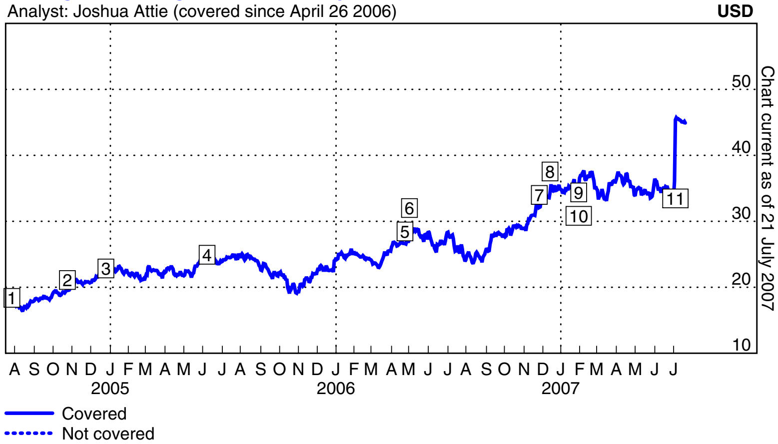
#	Date	Rating	Target Price	Closing Price
1:	1 Apr 05	3L	54.80	63.39
2:	23 Jun 06	*1M	*141.00	112.06
3:	27 Sep 06	*1L	*168.00	137.34
4:	27 Sep 06	1L	168.00	137.34
5:	8 Jan 07	1L	*187.00	152.00

*Indicates change.

Hilton Hotels Corp. (HLT)

Ratings and Target Price History - Fundamental Research

Analyst: Joshua Attie (covered since April 26 2006)



#	Date	Rating	Target Price	Closing Price
1:	28 Jul 04	1M	*21.00	17.98
2:	25 Oct 04	1M	*23.00	19.53
3:	27 Dec 04	1M	*26.00	22.51
4:	8 Jun 05	1M	*29.00	24.92
5:	25 Apr 06	1M	*33.00	26.62
6:	2 May 06	1M	*34.00	27.26
7:	27 Nov 06	1M	*39.00	32.10
8:	13 Dec 06	1M	*40.00	34.37
9:	31 Jan 07	1M	*43.00	35.39
10:	31 Jan 07	1M	*43.00	35.39
11:	5 Jul 07	*2M	*47.50	45.39

*Indicates change.

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Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from EIH, Hilton Hotels Corp. and Indian Hotels.

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Citigroup Investment Research Ratings Distribution

Data current as of 19 July 2007	Buy	Hold	Sell
Citigroup Investment Research Global Fundamental Coverage (3320)	47%	39%	14%
% of companies in each rating category that are investment banking clients	71%	70%	70%
India -- Asia Pacific (144)	64%	11%	25%
% of companies in each rating category that are investment banking clients	89%	94%	83%
Lodging -- North America (12)	42%	50%	8%
% of companies in each rating category that are investment banking clients	100%	83%	100%

Guide to Fundamental Research Investment Ratings:

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Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).

Investment ratings are a function of Citigroup Investment Research's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

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for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return).
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