

Morgan Stanley India Company
Private Limited+

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Stock Rating
Equal-weight

Industry View
In-Line

Hotel Leelaventure Limited

Operating Margins Improve; Maintain EW

What's Changed

Price Target	Rs30.00 to Rs45.00
F2010 EPS	From Rs0.42 to Rs1.08
F2011 EPS	From Rs1.15 to Rs2.19

Investment conclusion: We maintain our Equal-weight rating on Hotel Leelaventure, but are increasing our price target to Rs45 primarily to factor in an improving operating performance. The company reported an EBITDA margin of 40% in F3Q10, an 18ppt sequential improvement, primarily due to better absorption of costs on an increase in RevPARs. Accordingly, we have revised our EBITDA margin assumptions upwards for F2010 from 24.1% to 32.3% and for F2011 from 33.3% to 41.5%. We maintain our EW as the upside to our bull-case scenario is not substantial.

F3Q10 results were strong: Hotel Leelaventure reported strong F3Q10 revenue of Rs1,277mn (up 5% YoY and 40% QoQ). Adjusted profit was Rs289mn (down 10% YoY), which was significantly higher than the Rs18mn recorded in F2Q10. For F9M10, the EBITDA margin rose to 29.6% and given the recovery in demand, we expect margins to trend up. As well, the board of directors approved a capital-raising plan of up to US\$130mn through a combination of FCCB issuance and QIP to finance expansion plans and reduce debt.

Where we could be wrong: Better-than-expected RevPARs across cities and better operating margins could drive stock performance.

Key Ratios and Statistics

Reuters: HTLE.BO Bloomberg: LELA IN

India Hotels

Price target	Rs45.00
Upside to price target (%)	(4)
Shr price, close (Feb 11, 2010)	Rs46.95
52-Week Range	Rs52.40-16.00
Sh out, dil, curr (mn)	463
Mkt cap, curr (mn)	Rs21,715
Avg daily trading value (mn)	Rs19

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
ModelWare EPS (Rs)	1.39	1.08	2.19	3.28
Prior ModelWare EPS (Rs)	-	0.42	1.15	2.09
Revenue, net (Rs mn)	4,522	4,402	6,277	8,081
EBITDA (Rs mn)	1,559	1,420	2,607	3,360
ModelWare net inc (Rs mn)	643	502	911	1,367
P/E	13.4	43.3	21.5	14.3
P/BV	0.4	1.1	1.0	0.9
EV/EBITDA	19.6	33.9	18.6	14.0
Div yld (%)	2.2	0.6	1.1	1.3

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
e = Morgan Stanley Research estimates

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Hotel Leelaventure: Financial Summary

Profit and Loss Statements

Rs Mn	F2009	F2010E	F2011E	F2012E
Total revenue	4,522	4,402	6,277	8,081
Employee Cost	884	953	1,198	1,573
Food and Beverage Consumed	288	320	395	504
Fuel, Power and Light	447	443	542	691
Other operating expenses	1,344	1,265	1,536	1,953
Total operating expenses	2,963	2,982	3,670	4,721
EBITDA	1,559	1,420	2,607	3,360
Depreciation	549	604	962	1,057
EBIT	1,010	816	1,645	2,303
Other Income	236	170	172	209
Interest expense	267	226	436	442
PBT	979	760	1,380	2,071
Tax	336	258	469	704
Net Profit	643	502	911	1,367
Preference dividend	0	0	0	0
Net Profit after preference dividend	643	502	911	1,367
Exceptional items	806	7	0	0
Net Profit after exceptional items	1,450	509	911	1,367
ModelWare EPS (Rs)	1.39	1.08	2.19	3.28
Basic EPS (Rs)	1.70	1.33	2.41	3.62
DPS (Rs)	0.40	0.30	0.50	0.60

Balance Sheets

Rs Mn	F2009	F2010E	F2011E	F2012E
Liabilities				
Share Capital	756	756	756	756
Additional paid in capital	0	0	0	0
Reserves and Surplus	18,643	18,936	19,542	20,560
Less: Miscellaneous Expenditure	0	0	0	0
Total Shareholders Funds	19,399	19,691	20,298	21,316
Preference shares	0	0	0	0
Loan Funds	24,495	28,735	29,452	29,452
Deferred Tax Liability	1,004	1,004	1,004	1,004
TOTAL LIABILITIES	44,898	49,430	50,754	51,772
Assets				
Gross Fixed Assets	38,870	40,828	48,878	51,528
Accumulated Depreciation	3,985	4,672	5,717	6,857
Net Block	34,885	36,156	43,160	44,670
Capital Work-in-Progress	9,345	12,000	6,000	4,000
Net Fixed Assets	44,231	48,156	49,160	48,670
Investments	1	1	1	1
Current Assets	3,581	3,600	3,713	3,970
Cash and Cash Equivalents	306	126	390	1,784
Less: Current Liabilities	3,221	2,452	2,511	2,653
Net Current Assets	666	1,274	1,592	3,101
TOTAL ASSETS	44,898	49,430	50,754	51,772

Cash Flow Statements

Rs Mn	F2009	F2010E	F2011E	F2012E
PAT	643	502	911	1,367
Depreciation	549	604	962	1,057
Exceptional items	806	7	0	0
Change in working capital	1,026	(787)	(55)	(114)
Cash Flow From Operations	3,025	325	1,818	2,309
(Purchase)/sale of fixed assets, net	(18,555)	(4,529)	(1,966)	(566)
(Purchase)/sale of investment, net	0	0	0	0
Cash Flow From Investing Activities	(18,555)	(4,529)	(1,966)	(566)
Proceeds from equity issuance	(256)	0	0	0
Proceeds from preference share issuance	0	0	0	0
Proceeds/(repayment) of loan	4,139	4,240	717	0
Dividend paid	(177)	(133)	(221)	(265)
Other items	9,172	(84)	(84)	(84)
Cash Flow From Financing Activities	12,877	4,024	412	(349)
Change in cash and cash equiv	(2,653)	(179)	263	1,394
Opening cash and cash equiv	2,958	306	126	390
Closing cash and cash equiv	306	126	390	1,784

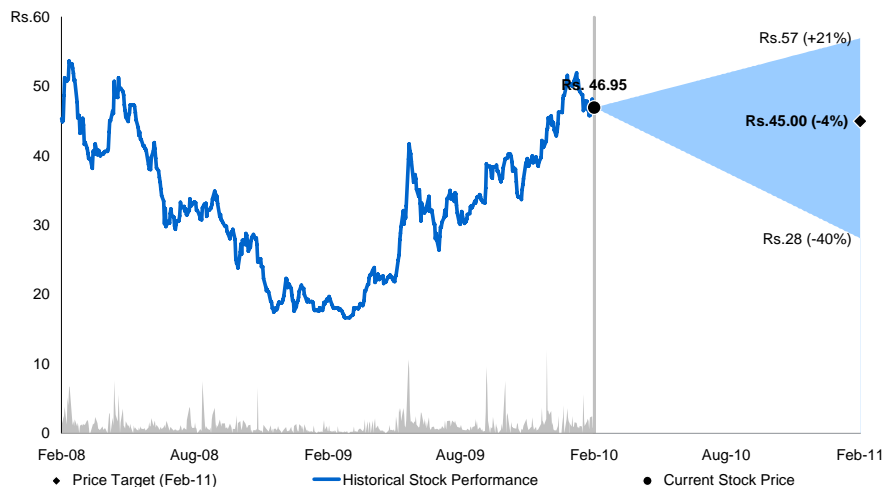
Ratio Analysis

	F2009	F2010E	F2011E	F2012E
Growth (%)				
Revenues (%)	-12%	-3%	43%	29%
EBITDA (%)	-32%	-9%	84%	29%
EBIT (%)	-45%	-19%	102%	40%
EBT (%)	-45%	-22%	82%	50%
Net Profit (%)	-41%	-22%	82%	50%
EPS (%)	-39%	-22%	102%	50%
Margins (%)				
EBITDA (%)	34.5%	32.3%	41.5%	41.6%
EBIT (%)	22.3%	18.5%	26.2%	28.5%
EBT (%)	21.7%	17.3%	22.0%	25.6%
Net Profit (%)	14.2%	11.4%	14.5%	16.9%
Return (%)				
ROE * (%)	7.0%	5.4%	9.4%	13.1%
ROCE (%)	2.7%	1.7%	3.3%	4.5%
ROA (%)	1.6%	1.0%	1.7%	2.5%
Gearing				
Debt/Equity	1.26	1.46	1.45	1.38
Debt/Equity (adj for revaluation reserve)	2.70	3.07	2.96	2.68
Net Debt/Equity	1.25	1.45	1.43	1.30
Valuations				
EV/EBITDA	29.4	35.4	18.7	14.1
P/E	33.8	44.3	21.5	14.3
P/BV	1.1	1.1	1.0	0.9
P/BV*	2.4	2.4	2.0	1.8
Dividend Yield (%)	0.9%	0.6%	1.1%	1.3%
Turnover (days)				
Inventory	53	55	55	55
Debtors	24	25	25	25
Creditors	91	60	60	60

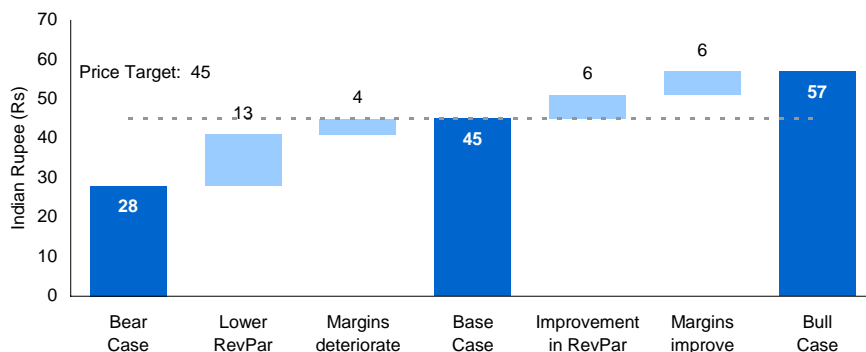
E = Morgan Stanley Research estimates; Source: Company data, Morgan Stanley Research
* adjusted for revaluation reserve of Rs10.3bn

Risk-Reward Snapshot: Hotel Leelaventure (HTLE.BO, Rs46.95, EW, PT Rs45)

Risk-Reward: Capacity Addition, Improving RevPAR to Boost Earnings



Price Target Rs45	Derived from base case fair value.
Bull Case Rs57	Better RevPAR and margins: We assume average RevPAR increases by 32% in F2011 and 7% in F2012. Operating margin moves up to 44.4% at the end of F2012.
Base Case Rs45	Improvement in operating margins: We assume EBITDA margins of 32.3% in F2010 and 41.5% in F2011 due to better absorption of costs on the back of improving RevPARs. We use a WACC of 11.1% and a terminal growth rate of 5% in our DCF model.
Bear Case Rs28	RevPARs grow slowly across locations and margins are pressured: We assume average RevPAR increases by 22% in F2011 and by 6% in F2012. Operating margins decline to 38% in F2012.



Source: FactSet, Morgan Stanley Research

Investment Thesis

- Improving macro outlook should help earnings. Also, liquidity constraints are easing, which makes us less cautious.
- **New room inventory to be added:** The company plans to add 730 rooms between F2010 and F2012, which will help earnings.

Key Value Drivers

- **Average room rates:** We have assumed ARR to fall in F2010 before picking up in the subsequent years. Any strength in RevPAR can boost profitability.
- **Capacity expansion:** New capacity is expected in Udaipur, Chennai, New Delhi, and Agra, which will help earnings.

Potential Catalysts

- Significant increase in tourism activity
- Sharp recovery in ARR and OR, especially those in Mumbai and Bangalore.

Key Risks

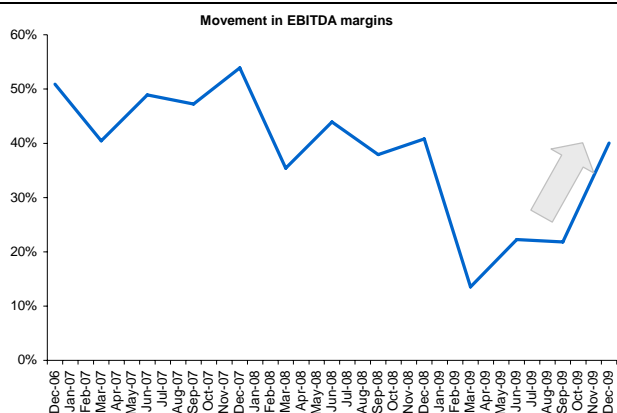
- **Bangalore exposure:** Hotel Leela derives about 40% of its revenue from the Bangalore market. Any slowdown in this market could hurt earnings.
- Steep decline in ARR and ORs primarily in Bangalore and Mumbai.
- Delay in capacity additions.
- High gearing coupled with higher interest cost.

Hotel Leelaventure

We maintain our Equal-weight rating on the stock but are increasing our price target to Rs45 primarily to factor in an improving operating performance. Some key points are as follows:

- The company reported an EBITDA margin of 40% in F3Q10, which was an 18ppt sequential improvement, primarily due to better absorption of costs on the back of an increase in RevPAR. As a result, we believe F4Q10 results will be strong on a YoY basis as F4Q09 was weak due to the Mumbai terror attacks. Accordingly, we have revised our EBITDA margin assumptions upward for F2010 from 24.1% earlier to 32.3% and for F2011 from 33.3% earlier to 41.5%.

Exhibit 1
EBITDA Margins Improve

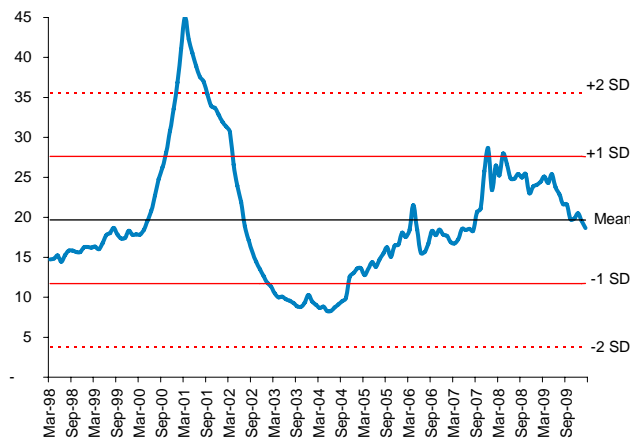


Source: Company data, Morgan Stanley Research

- Mumbai RevPARs jumped 50% sequentially due to an improvement in ORs from 55% in F2Q10 to 78% in F3Q10. Goa and Kovalam witnessed 121% and 107% QoQ increases in RevPARs, due to improvement in both ARRs and ORs. Bangalore saw a muted growth of 9% QoQ. We believe ORs have strengthened and the company may be looking for ARR increases going forward.
- The New Delhi hotel is slated to open in August 2010 with 290 rooms. Further, the Chennai property with 360 rooms is expected to be released in F2012. We understand Agra and Jaipur maybe the other two cities where the company may add capacity beyond F2012. We believe the addition of new rooms will help revenue growth.

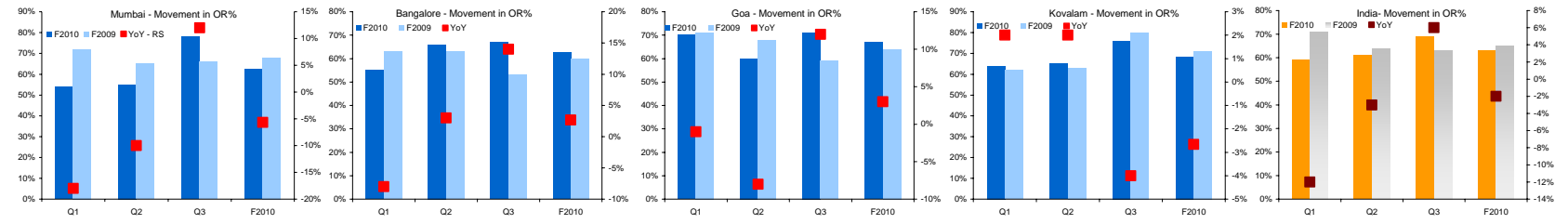
- Debt remains an issue for the company, however. The company has bought back 59% of its FCCB bonds and 24% of its Euro bonds at a discount to the accreted price. The board of directors has also approved a capital-raising plan of up to US\$130mn through a combination of FCCB issuance and QIP to finance expansion plans and reduce debt.
- The stock has outperformed the Sensex by 4% YTD and by 27% in the last three months. The stock is currently trading at 18.6x 12-month forward EV/EBITDA multiple and 1.8x adjusted P/B. We maintain our EW as we believe the upside to our bull-case scenario is not substantial.

Exhibit 2
Hotel Leela: EV/EBITDA



Source: Company data, Morgan Stanley Research

Exhibit 3
Movement in OR (%)



Source: Company data, Morgan Stanley Research

Exhibit 4
Movement in ARR



Source: Company data, Morgan Stanley Research

Exhibit 5

Hotel Leela: F9M10 performance

Rs mn	9MF2009	9MF2010	YoY
Revenue	3549	3036	-14%
Expenditure	2093	2137	2%
Consumption of Raw Materials	219	221	1%
Staff Cost	634	698	10%
Fuel, Power & Light	336	324	-4%
Other Expenditure	904	894	-1%
EBIDTA	1455	899	-38%
EBIDTA Margin %	41.0%	29.6%	-1141 bps
Depreciation	356	463	30%
EBIT	1100	435	-60%
Other Income	263	128	-51%
Interest	188	169	-10%
PBT	1174	394	-66%
PBT Margin %	33.1%	13.0%	-2011 bps
Tax	185	85	-54%
Tax Rate %	16%	21%	572 bps
Profit after Tax	989	309	-69%
PAT Margin %	27.9%	10.2%	-1768 bps
Exceptional Items	-209	7	-103%
Reported Net Profit	780	316	-59%

Source: Company data, Morgan Stanley Research

Valuations

We have increased our basic EPS estimates from Rs0.51 to Rs1.08 for F2010 and Rs1.27 to Rs2.41 for F2011 due to an increase in our EBITDA margin estimates. This is largely based on the EBITDA margin reported in F3Q10 results and on the belief that better RevPAR will drive margins. We continue to peg our price target to our DCF model base-case fair value, which is now Rs45. Our DCF model assumes a WACC of 11.1% and a terminal growth rate of 5% (see Exhibits 6-7).

Key downside risks to our Hotel Leela target price are substantial declines in average room rates and occupancy rates. Upside risks include increasing ARR and improving ROE. Other industry-specific risks include a slowdown in tourist inflow and/or a reduction in corporate travel budgets.

Exhibit 6

Hotel Leela: Cost of Capital Assumption

WACC	
Equity portion (%)	50%
Debt portion (%)	50%
Beta	1.07
Risk free rate (%)	7.50%
Market premium (%)	6.00%
Cost of equity (%)	13.9%
Debt (%)	11.00%
Tax rate (%)	25.00%
Cost of debt (%)	8.25%
WACC (%)	11.1%
Terminal Growth Rate	5%

Source: Bloomberg, Company data, Morgan Stanley Research

Exhibit 7

Hotel Leela: DCF Valuation

	F2009	F2010	F2011	F2012	F2013	F2014	F2015
Revenue	4522	4402	6277	8081	9697	11636	13964
YoY growth (%)	-12	-3	43	29	20	20	20
EBIT	1010	816	1645	2303	2927	3697	4628
Margin (%)	22	19	26	29	30	32	33
Effective tax rate (%)	34.3	34.0	34.0	34.0	34.0	34.0	34.0
EBIT (1-Tax)	663	539	1086	1520	1932	2440	3055
Depreciation	453	549	604	962	1057	1105	1141
Capex	-18555	-4529	-1966	-566	-516	-516	-516
Change in Working Capital	1026	-787	-55	-114	-103	-108	-129
Other Investments and non-cash items	0	0	0	0	0	0	0
Net investment in Capital	-17075	-4766	-1418	281	437	481	496
Free cash flow	-16412	-4228	-332	1802	2369	2921	3551
Compounding period			0	1	2	3	4
Discounting factor			1.00	0.90	0.81	0.73	0.66
PV of cash flows			-332	1622	1920	2131	2332

Sum of FCF, excl. Terminal Value	7673
PV of Terminal Value	38323
Firm value	45996
Debt	29452
Cash	390
Equity Value	16933
# shares outstanding	377.8
Equity value/share	45

Source: Company data, Morgan Stanley Research

Exhibit 8

Global valuation

Name	Currency	Stock Price	52 Week Range	M Cap (US\$ mn)	EPS			P/E			P/B			EV/EBITDA		
					F10/C09	F11/C10	F12/C11	F10/C09	F11/C10	F12/C11	F10/C09	F11/C10	F12/C11	F10/C09	F11/C10	F12/C11
European Companies																
Accor	EUR	35	25-40	10,682	1.2	1.2	1.8	31.8	29.9	19.8	2.3	2.1	2.0	9.9	9.1	7.7
InterContinental Hotels Group	GBp	911	434-950	4,155	0.8	0.6	0.8	17.6	22.2	17.7	NM	99.2	26.7	11.3	11.9	9.7
Whitbread	GBp	1373	687-1457	3,861	89.4	93.6	93.9	8.3	14.7	14.6	0.9	1.6	1.5	6.8	9.6	9.3
					Average:			19.2 x	22.3 x	17.4 x	1.6 x	34.3 x	10.0 x	9.3 x	10.2 x	8.9 x
American Companies																
Marriott International	USD	26	12-30	9,431	0.9	0.9	1.1	30.6	29.8	24.0	7.6	6.3	4.8	14.4	13.6	11.1
Starwood Hotels & Resorts	USD	37	9-40	6,880	0.7	1.0	1.5	55.2	37.4	23.9	3.5	3.1	NM	12.7	10.9	9.4
Host Hotels & Resorts	USD	11	3-13	6,696	0.6	-0.1	-0.3	17.6	NM	-41.7	1.1	1.2	NM	13.2	14.1	12.9
Choice Hotels International	USD	31	23-34	1,873	1.7	1.7	1.8	18.9	18.8	17.0	NM	NM	629.2	13.1	12.7	11.2
					Average:			27.1 x	26.2 x	8.5 x	3.3 x	3.5 x	317.0 x	12.2 x	11.8 x	10.4 x
Asia Pacific Companies																
Shangri-La Asia Ltd.	HKD	13	7-16	4,963	0.3	0.5	0.8	42.3	27.4	17.5	1.2	1.2	1.1	22.1	15.5	12.3
Hong Kong & Shanghai Hotels Ltd.	HKD	11	4-12	2,081	0.3	0.5	0.6	36.2	22.9	17.6	0.7	0.7	0.7	18.1	13.7	10.7
Mandarin Oriental International Ltd.	USD	1	1-2	1,348	0.1	0.0	0.1	15.2	30.1	22.8	1.3	1.3	1.3	26.1	15.4	13.4
Central Plaza Hotel PCL	THB	4	3-5	160	0.1	0.3	0.4	46.4	14.0	11.0	0.8	0.8	0.8	3.6	2.5	2.3
Minor International	THB	11	6-13	1,199	0.4	0.6	0.7	27.4	19.2	15.1	2.9	2.6	2.3	11.7	9.7	7.7
					Average:			33.5 x	22.7 x	16.8 x	1.4 x	1.3 x	1.2 x	16.3 x	11.4 x	9.3 x
India Companies																
Indian Hotels Company Ltd	INR	90	34-110	1,409	-0.8	0.6	3.2	NM	147.2	28.3	2.1	2.1	2.0	31.2	19.0	13.0
EIH Limited	INR	124	85-154	1,051	1.7	2.8	5.6	71.1	43.9	22.1	3.3	3.2	2.9	41.0	29.9	16.4
Hotel Leelaventure Limited	INR	47	16-52	469	1.1	2.2	3.3	43.4	21.5	14.4	1.1	1.0	0.9	35.5	18.7	14.1
					Average:			57.3 x	70.9 x	21.6 x	2.2 x	2.1 x	1.9 x	35.9 x	22.5 x	14.5 x

Data for Indian Companies is for Fiscal Year end March 31st

Prices are as of February 11 for Asian and Indian companies and as of February 10, 2010 for the others

All American and Asian companies barring Minor International are FactSet mean estimates

NM= Not Meaningful

NA= Not Available

Source: Company data, FactSet, Morgan Stanley Research

Company Description

The Leela Group owns four hotel properties in India in the premium and leisure segments. It is a market leader in the cities of Bangalore and Goa.

India Hotels

Industry View: In-Line



Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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Global Stock Ratings Distribution

(as of January 31, 2010)

For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	999	40%	296	41%	30%
Equal-weight/Hold	1088	43%	333	46%	31%
Not-Rated/Hold	21	1%	4	1%	19%
Underweight/Sell	396	16%	90	12%	23%
Total	2,504		723		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

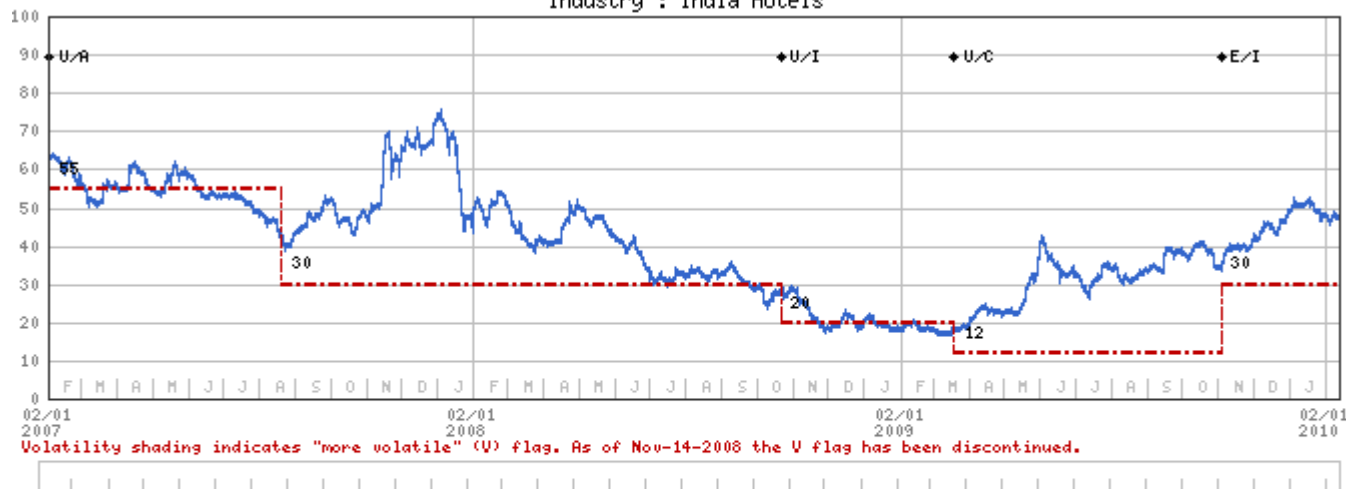
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock Price, Price Target and Rating History (See Rating Definitions)

Hotel Leelaventure Limited (HTLE.BO) - As of 2/11/10 in INR
Industry : India Hotels



Stock Rating History: 2/1/07 : U/A; 10/21/08 : U/I; 3/18/09 : U/C; 11/3/09 : E/I
Price Target History: 11/2/06 : 55; 8/20/07 : 30; 10/21/08 : 20; 3/18/09 : 12; 11/3/09 : 30

Source: Morgan Stanley Research Date Format: MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: India Hotels

Company (Ticker)	Rating (as of)	Price* (02/11/2010)
Parag Gupta		
EIH Limited (EIHO.BO)	U (11/02/2006)	Rs124
Hotel Leelaventure Limited (HTLE.BO)	E (02/12/2010)	Rs46.95
Indian Hotels Company Ltd (IHTL.BO)	O (11/03/2009)	Rs90.25

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* Historical prices are not split adjusted.