

INTERNATIONAL TRAVEL HOUSE

INR 143

One stop shop

BUY

* **Booming tourism industry**

The USD 53.5 bn Indian tourism industry (2006) is slated to grow to USD 128 bn by 2016 (*Source: World Travel & Tourism Council (WTTC)*), led by Government of India's (Gol's) tourism promotion efforts through 'Incredible India' campaign, strong economic growth, rising income levels, consumerism, and increasing business, and domestic travel. International Travel House Ltd (ITHL) is amongst the few end to end providers in the industry and is well poised to benefit from the current boom. Besides providing car rentals, air-line booking, tour packages and various other services, ITHL has its travel desk at every ITC hotel thus having its presence across the entire value chain.

* **Branded car rental market: A huge opportunity awaiting**

Out of the INR 90 bn Indian car rental market, ~ 90% is dominated by unorganized players. However, with the recent entry of international players like SIXT, Europcar, and LeasePlan in India, the dynamics of the car rental business are set to change. We expect the car rental industry to grow at a rate of 23-25% over the next three to five years. ITHL owns 650 cars and has 200 leased cars. We expect commissions from the car rental segment to grow at 32.5% CAGR over FY07E-09E, contributing 72% to the total commissions in FY09E.

* **Portal to enhance retail presence**

The USD 796 mn (2006) online travel market in India is expected to surpass USD 2 bn by 2008. (*Source: PhoCusWright Inc.*) The wealth of opportunities has attracted significant investment in the online travel agency space, into which four venture capital funded players have already entered, speeding up the online transition. We expect a demographic shift to take place towards online travel service providers with increased internet penetration and growing middle class. ITHL plans to launch its portal along with the payment gateway by end of Q108 thus enhancing its retail presence. We expect the portal to contribute INR 10 mn in FY08E and INR 30 mn in FY09E to the total commissions.

* **Valuations**

Given the booming tourism sector, the ITC pedigree, launch of portal, and strong focus on the car rental industry, the prospects of ITHL appear extremely bright. We expect ITHL's revenues and profits to grow at 29% and 33% CAGR, respectively, between FY07E and FY09E. At the CMP of INR 143, the stock trades at 12.6x FY07E EPS of INR 11.3 and 9.3x FY08E EPS of INR 15.3. We initiate coverage with a **'BUY'** recommendation.

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	606	797	1,047	1,322
EBITDA (INR mn)	180	235	319	410
Net profit (INR mn)	70	90	122	161
EPS (INR)	8.8	11.3	15.3	20.1
EPS growth (%)	49.9	29.1	35.4	31.2
PE (x)	16.3	12.6	9.3	7.1
EV/EBITDA (x)	6.8	5.6	4.1	3.0
Dividend yield (%)	1.7	1.7	1.7	1.7
ROE (%)	15.8	18.0	20.9	22.8

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Market Data

52-week range (INR) : 279 / 141
Share in issue (mn) : 8.0
M cap (INR bn/USD mn) : 1.1 / 25.7
Avg. Daily Vol. BSE ('000) : 16.2

Share Holding Pattern (%)

Promoters : 61.7
MFs, FIs & Banks : 1.4
FIs : 0.0
Others : 36.9



Risks

- ♦ Natural calamities may lead to slowdown in tourist's arrival
- ♦ Slowdown in the Indian economy

Industry overview

Travel and tourism in India is expected to generate USD 53.5 bn of economic activity in 2006, which is slated to go up to USD 128 bn by 2016. This industry is expected to grow at 8% per annum between 2007 and 2016. India's share in the world tourism market is expected to grow from 0.8% currently to 1.05% by 2016. (*Source: WTTC*)

* Aviation industry on a high growth path

With the number of airlines going up to 10, India is one of the most dynamic aviation markets to be in. The aviation industry is slated to grow by 25% CAGR till 2010. Also, by 2010; Indian airports will be handling between 90 and 100 mn passengers per year from the current 34 mn passengers (CY06). We expect nearly 80% of this growth to be driven by the low cost carrier segment (LCC). By 2008, the LCC's would capture 65% of the direct online air ticket market from 61% in 2005. (*Source: PhoCusWright Inc.*)

* After low cost carriers, budget hotels would go online

Travel accommodation in India accounts for only 12% of the travel and tourism industry in value terms. The huge gap between demand and supply of hotel rooms has taken occupancy levels and average room rates (ARR's) to new highs during FY06 and H107. In addition, nearly 70% of the Indian hotel market is fragmented, offering wide choice to customers through online travel agents or websites. The online booking system also reduces time spent on every call per customer by the sales executive. Also in contrast to air ticketing, where the commission is just 4% of the billing, the hotel booking commission can be as high as 10% to 25% which would attract the players in the online space.

Company Overview

Established in 1981, ITHL is a part of ITC group and among the largest total travel management companies in India in which ITC holds 62% stake. It has presence across cities with a network of 10 International Air transport Association (IATA) travel offices, 10 car rental offices, and 14 hotel travel counters at the ITC group of hotels working 24x7 as 'Anytime Travel Desk'. Around 11% of revenues in FY06 came from the ITC group.

The company offers full bouquet of travel solutions and services like air tickets, car rental, inbound tourism, overseas and domestic holiday packages, business travel, destination management services, incentive group travel, foreign exchange, conferences, and events and exhibition management.

ITHL's forte is the corporate travel segment that is growing at 20% due to current boom in the economy. ITHL caters to 185 corporate clients including Sun Microsystems, Bharati Airtel, Siemens Citibank, Infosys, and ABN Amro, apart from ITC group.

ITHL is recognised and approved as a travel agent and tour operator by the IATA and the Department of Tourism, Govt. It is also affiliated to key professional bodies including World Tour organisation, Universal Federation of Travel Agents Association, American Society of Travel agents, International Congresses & Conventions Association, and the Travel Agents Association of India. ITHL has signed a MoU with Rosenbluth International Alliance, US for cross reference of business and client servicing. Citigroup has entered into an agreement with the company for sale of Citigroup travelers' cheque and Visa traveler cheques.

* Business segments

- ♦ **Car rental** - ITHL is amongst the top five players (largest player Hertz has a fleet 2000 cars) in the domestic car rental industry with 25 years of existence. ITHL owns a fleet of 650 cars and has 200 cars on lease with an option of self-drive and chauffeur driven cars. The fleet includes a wide range of models to suit its customers, with a choice of five categories: premium, royal plus, royal, club plus, club, and comfort. Recently ITHL changed its depreciation policy from 8 years to 4 years. Also, the average age of the fleet is just 3 years. The commissions in this division for ITHL are as high as 67.5% of billing (as on FY06). We expect commissions from this division to grow at a CAGR of 32.5% over FY07E to FY09E, contributing 72.2% to total commissions in FY09E.
- ♦ **Air ticketing** - One of the major reasons for popularity of online air ticketing in India is the advent of low cost-carriers (LCC). LCC currently represents nearly 40% of the domestic gross air bookings, in less than three years of operations. Air ticketing contributes 83% (as on FY06) to ITHL's total billing, while fetching only ~4% as commission. Due to increased penetration of LCC through the online channel, commissions are likely to reduce with increase in volumes. We expect commissions from this division to grow at CAGR of 19.9% over FY07E to FY09E, contributing 21.4% to total commissions in FY09E.
- ♦ **Online portal: The future sales channel for the industry**

The travel market in India, which is projected to quadruple over the next two years, is subject to a unique blend of forces (both on the demand and supply side) driving growth in an online channel. Online travel agencies will rapidly change the old paradigm, providing customers with a sophisticated online shopping experience, enabling access to fragmented travel supply market, and consolidating Indian travel options with a pan-India approach. ITHL's plan to launch its portal along with the payment gateway by end of Q108

augurs well in the current scenario. We expect the portal to contribute INR 10 mn in FY08E and INR 30 mn in FY09E to the total commissions. However, we believe that revenues from portal can scale up significantly, which would affect the margins and return ratios positively.

Table 1: Recent funding by venture capital funds

Online Portal		Funding	Venture Capital
Travelguru.com	1st round	USD 10 mn	Westbridge Capital (now Sequoia Capital)
	2nd round	USD 15 mn	Battery Ventures and Sequoia Capital India
MakeMyTrip.com	1st round	USD 10 mn	Softbank Asia Infrastructure Fund (SAIF)
	2nd round	USD 13 mn	Helion Ventures, Sierra Venture Capital and SAIF
Cleartrip.com	1st round	USD 5 mn	Sherpalo and Kleiner Perkins Caufield and Byres
	2nd round	USD 8 mn	DAG Ventures , Shaerpalo Ventures
Yatra.com	1st round	USD 5 mn	Reliance Capital , Norwest Venture and TV18

Source: Edelweiss research

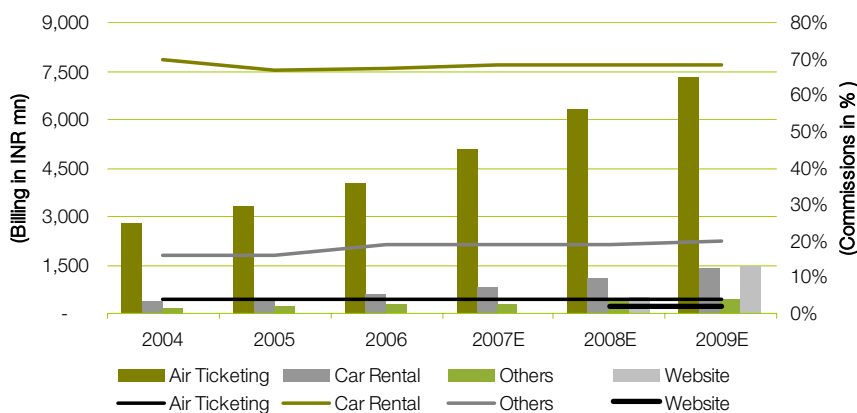
The above table shows the investments made by venture capital funds in various online travel portals. An infusion of USD 66 mn in venture capital for online travel agencies in India within the past 12 months is a testament to the potential in this distribution channel. We believe, once the portal for ITH starts functioning and contributing significantly to the revenue, there is a likelihood of valuation re-rating happening.

◆ **Other services**

ITHL has taken a lead in developing innovative travel related products and services such as cruises, pre-packaged tours, Indian gateways, world class holidays, conferences, money changer, and fair-n-festivals. These services offer higher commission (19% of billing in FY06) compared with pure air ticketing. We expect commissions from this division to grow at CAGR of 20% over FY07E to FY09E, contributing 6.5% to total commissions in FY09E.

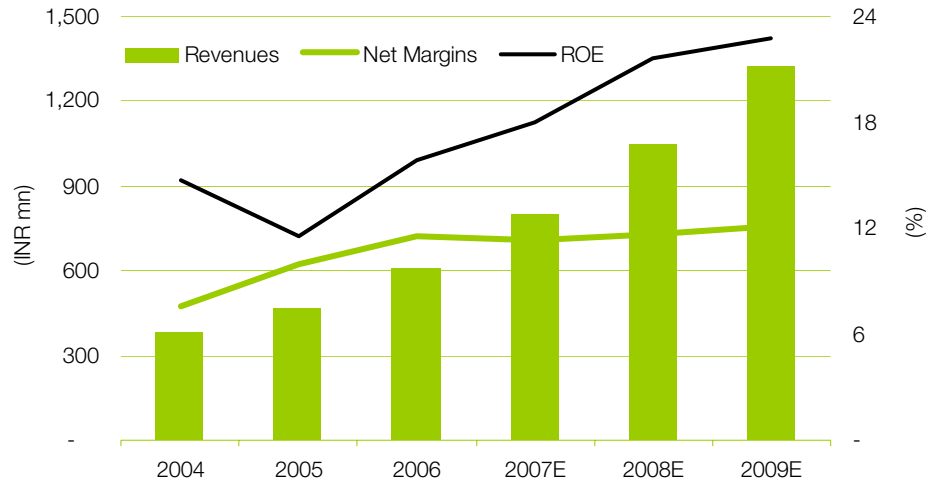
* **Changing revenue mix, enhancing margins and return ratios**

Chart 1: Revenue break-up



Source: Company, Edelweiss research

Chart 2: Increasing net margins and return ratios



Source: Edelweiss research

As shown in the above two graphs, share of air-ticketing (as a percentage of total commissions) is decreasing, whereas share of car rental business is increasing. This is primarily because of a likely decline in commissions from air-ticketing. Volumes, are however, likely to increase due to growing online market share of LCC. At the same time, the high-commission car rental segment is likely to contribute more to the commissions. This would lead to increasing margins and improved return ratios.

Any positive upside from the portal is not captured and would affect the margins and ratios positively. We thus expect the net margins to increase from 11.3% in FY07E to 12.2% in FY09E, whereas the ROE to increase from 18% in FY07E to 22.8% in FY09E.

Table 2: Peer comparison

	Expedia*	Ctrip.com*	Sabre Holdings*	ITHL*
Sales (in mn) **	2,596	197	3,180	1,047
EBITDA (in mn)*	751	67	664	319
EBITDA (%)	28.9	33.8	20.9	30.5
Net profit (in mn)*	453	59	269	122
Net profit (%)	17.5	30.2	8.5	11.7
P/E (x)	15.8	33.2	15.1	9.3
P/Sales (x)	2.5	10.7	1.3	1.1
ROE (in %)	6.7	32.0	12.9	21.6

Source: Bloomberg, Edelweiss research

* Financials for ITH for FY08E, rest CY08E

** Sales for ITH in INR mn rest all in USD mn

From the above table we observe that ITHL has better margins compared with Sabre Holdings (Travelocity.com) and superior return ratios as against Expedia. Also, a look at recent acquisition of TCI by Thomas Cook would give us a strong case to prove that ITHL is trading at a discount. Thomas Cook bought TCI for about 4.5x TCI's commission which was about INR 400 mn in FY06. ITHL in its comparison trades at lower multiple of 2.08x its commission of about INR 600 mn in FY06. Also TCI has no assets like cars which ITHL has. Thus, going ahead we believe that ITHL would command better multiples, given its superior return ratios and margins. There are potential upsides, once the portal starts contributing significantly to the revenues.

* **Outlook**

Growth in Indian tourism sector is supported by a strong economic growth of 8.6% over the past three years. With growing number of merger and acquisitions, business travel is also booming. Increasing income and growing middle class has given rise to consumerism, which has led to increase in the inbound tourism as well. We believe that this augurs well for ITHL and the industry as a whole over the next three to five years. Going forward, we expect ITHL's revenues and profits to grow at 29% and 33% CAGR, respectively, between FY07E and FY09E. At the CMP of INR 143, the stock trades at 12.6x FY07E EPS of INR 11.3 and 9.3x FY08E EPS of INR 15.3. We initiate coverage with a **'BUY'** recommendation.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income from services rendered	469	606	797	1,047	1,322
Net sales	469	606	797	1,047	1,322
Employee cost	106	144	199	254	324
Cars related expenses	74	93	119	157	192
Marketing expenses	50	51	64	94	119
Service charges	53	69	96	115	145
Other expenses	50	57	72	92	112
Miscellaneous expenses	23	12	12	16	20
Total operating expenses	357	426	562	728	912
EBITDA	112	180	235	319	410
Other income	11	14	14	14	14
Interest expense	9	10	12	14	12
Depreciation	40	68	94	126	157
Profit before tax	74	117	143	194	255
Provision for tax	27	47	53	72	94
Net profit	47	70	90	122	161
Cash profit	87	138	185	248	318
Earnings per share	5.8	8.8	11.3	15.3	20.1
Shares outstanding	8.0	8.0	8.0	8.0	8.0
Dividend (INR/share) (%)	2.0	2.5	2.5	2.5	2.5

Common size metrics as % on revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	76.0	70.2	70.5	69.5	69.0
Depreciation	8.6	11.2	11.8	12.0	11.9
EBITDA margins	24.0	29.8	29.5	30.5	31.0
Net profit margins	10.0	11.6	11.3	11.7	12.2

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	23.0	29.2	31.4	31.5	26.2
EBITDA	55.3	60.6	30.2	35.9	28.3
Net profit	62.1	49.9	29.1	35.4	31.2
Cash profit	38.7	58.5	33.6	34.6	28.1
EPS	62.1	49.9	29.1	35.4	31.2

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	87	138	185	248	318
Cash for working capital	(51)	(9)	(42)	(69)	(17)
Net operating cash flow- A	37	129	143	180	301
Net purchase of fixed assets	(112)	(81)	(200)	(150)	(200)
Net purchase of investments	(52)	1	0	0	0
Net cash flow from investing- B	(163)	(81)	(200)	(150)	(200)
Proceeds/repayments from borrowings	70	(8)	50	0	(50)
Dividend payments	(18)	(23)	(23)	(23)	(23)
Net cash flow from financing- C	52	(31)	27	(23)	(73)
Net cash flow (A+B+C)	(75)	17	(30)	6	28

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	80	80	80	80	80
Reserves & surplus	340	387	454	554	691
Shareholders funds	420	467	534	634	771
Secured loans	153	144	194	194	144
Net deferred tax liability	25	26	26	26	26
Source of funds	598	637	754	854	941
Gross block	363	421	625	775	975
Depreciation	107	153	247	373	531
Net block	257	268	378	402	444
Capital work in progress	2	4	-	-	-
Investments	139	140	140	140	140
Cash, bank bal & deposits	43	60	30	36	65
Sundry debtors	389	442	581	763	905
Loans & advances	56	64	64	64	64
Total current assets	489	566	674	863	1,034
Sundry creditors	230	278	368	477	597
Others	38	30	30	30	30
Provisions	22	32	40	45	50
Proposed dividend	18	23	23	23	23
Others	4	10	10	10	10
Total current liabilities	289	341	438	551	677
Net current assets	200	225	237	312	357
Application of funds	598	637	754	854	941
Book value (BV) per share (INR)	53	58	67	79	96

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	11.5	15.8	18.1	21.0	22.9
ROCE (%)	10.1	13.0	14.7	16.9	19.2
Debtor days	303	266	266	266	250
Fixed assets t/o	1.8	2.3	2.1	2.6	3.0
Debt /Equity	0.4	0.3	0.4	0.3	0.2

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	5.8	8.8	11.3	15.3	20.1
<i>Y-o-Y growth (%)</i>	<i>62.1</i>	<i>49.9</i>	<i>29.1</i>	<i>35.4</i>	<i>31.2</i>
CEPS (INR)	10.9	17.3	23.1	31.1	39.8
PE (x)	24.5	16.3	12.6	9.3	7.1
Price/BV (x)	2.7	2.4	2.1	1.8	1.5
P/CEPS (x)	13.1	8.3	6.2	4.6	3.6
EV/EBITDA (x)	11.1	6.8	5.6	4.1	3.0

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