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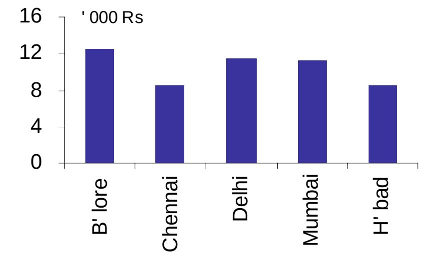
Sector Update | March 06, 2009

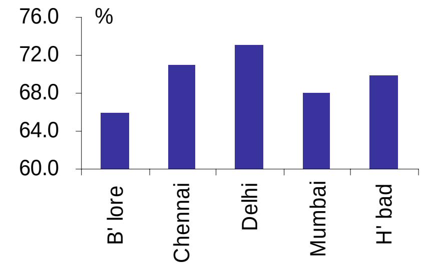
Hotels - 'Weak Outlook'

Projected FY09 ARRs in key cities



Source: India Infoline Research

Projected FY09 O.R in key cities



Source: India Infoline Research

Leading hotel chains reported yoy decline in sales and profit in Q3 FY09, largely in line with our expectations, as recession in developed markets trimmed foreign corporate travel. Nov' 08 attacks on Mumbai compounded the situation leading to a 15% yoy fall in Average Room Rates (ARRs) in Dec' 08. The companies we spoke to, maintain that demand has picked up from the Dec' 08 trough. But we believe it may not be enough to revive ARRs next year. Volume growth could be hampered beyond FY10 as companies are unlikely to commit any fresh investments and instead focus on accelerated completion of ongoing projects.

Indian Hotels has put on the backburner a few of its planned hotels as it freezes all uncommitted new projects. Although stock valuation has corrected, downside risks still remain in light of the tepid demand. EIH is even worse off, in our view, as a concentrated city-based portfolio of hotels may be impacted by lower ARRs in FY10. Maintain SELL on both the companies.

Indian Hotels: ARRs may drop further in FY10

Indian Hotels has scaled down some of its earlier uncommitted capital expenditure such as new hotels in Mumbai and Noida (Taj Residency). Lack of volume growth beyond FY10 remains a key concern although earnings may be aided by lower dilution than previously expected. Operating margins may stabilize in FY11 but likely to be below current year level as ARR growth remains muted. Maintain SELL.

EIH: Valuations remain expensive

The addition of the 437-room 'Trident' in Mumbai from April' 09 would impart volume growth in a difficult environment. However, we believe, it is unlikely to offset the impact of decline in ARRs and occupancies across the portfolio in FY10.

Post commissioning, Mumbai properties would account for about 60% of its standalone room inventory in CY10. The company trades at a hefty 162% premium to Indian Hotels FY10E P/E, which is not justified in our view. Retain our SELL rating on the stock.

Valuation summary

Y/e 31 March	Indian Hotels			EIH		
(Rs m)	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E
Revenues	27,674	27,214	30,918	9,885	10,928	13,353
yoy growth (%)	(5.2)	(1.7)	13.6	(14.6)	10.5	22.2
Operating profit	6,946	6,205	7,327	2,995	2,918	3,806
OPM (%)	25.1	22.8	23.7	30.3	26.7	28.5
Reported PAT	3,096	2,582	3,293	1,525	1,495	2,101
yoy growth (%)	(12.8)	(16.6)	27.5	(31.1)	(2.0)	40.5
EPS (Rs)	4.3	3.6	4.5	3.9	3.8	5.3
P/E (x)	8.1	9.7	7.6	24.8	25.3	18.0
P/BV (x)	0.6	0.6	0.6	2.9	2.7	2.5
EV/EBITDA (x)	6.8	7.6	6.3	16.6	16.9	12.8
Debt/Equity (x)	0.8	0.8	0.7	0.9	0.8	0.7
ROE (%)	10.1	6.6	8.1	11.9	11.0	14.4
ROCE (%)	8.9	6.9	8.2	14.6	13.3	16.5

Source: Company, India Infoline Research

Industry Update

Lack of volume growth beyond CY10

Lack of room additions may hamper volume growth beyond FY10

Depressed outlook for ARRs and tight credit conditions since Sep' 08 has meant companies are more focused on accelerated completion of ongoing projects rather than planning fresh inventory additions. Both Indian Hotels and EIH offer little visibility on capacity additions beyond FY10, which could hamper growth beyond FY10.

For instance, Indian Hotels would add 2,078 rooms in FY10 of which nearly 64% comprise Ginger hotels and management contracts. The company has put a freeze on uncommitted new projects as well as on routine capex. It has probably put on the back-burner several new hotels such as those in Mumbai (Taj Sanatcruz, 175 rooms), Noida (Taj Residency, 450 rooms) announced earlier.

Indian Hotels: upcoming projects

Expansion plans-2009-10	Rooms
In IHCL	
Taj Residency, Bangalore	330
Taj Falaknuma Palace, Hyderabad	60
Taj Surya, Coimbatore	189
Non-IHCL	
Six Ginger hotels	600
Taj Palace, Capetown	177
Management contracts	722
Total	**2,078**
Ginger + Mgmt contracts (% of total)	64

Source: Company

ARRs may remain weak in FY10

ARRs may remain weak in FY10 with Mumbai and Delhi likely to post 2-5% drop in room rates

In our management interactions, companies indicated average room rates for luxury hotels in the five major cities may reach a bottom in FY10 with signs of incipient recovery likely to be visible in occupancy rates before any up tick in ARRs. Below we sum up the current scenario in major destinations and outlook for FY10.

City	Comment	FY10E outlook
Bangalore	ARRs likely to decline 30-35% yoy in FY09 to about Rs11,000-12,000 with O.R in the range of 65-68%	We expect another 8-9% drop in room rates while occupancies could stabilize around 65-70%
Chennai	Relative stable with room rates down by about 4-5% yoy and occupancies likely to hover around 70-75% in FY09	Room tariffs seen flat yoy; occupancies may improve from Oct' 09
Delhi	ARRs have seen faster recovery as compared to Mumbai; we forecast 3% ARR drop in current year	FY10E room tariffs may drop another 2-3% yoy
Mumbai	ARRs may decline 5-6% across luxury hotels; O.R may fall 300-400bps yoy	Room tariffs may decline another 3-5%, may mark a bottom of current cycle
Hyderabad	Current year rates may drop in line with our estimate of 8-10% yoy to about Rs8,500; occupancies could drop 300-400bps yoy to 70%	ARRs may decline further by 4-5% on tepid demand; O.R may remain at 68-70% levels

Source: Industry, India Infoline Research

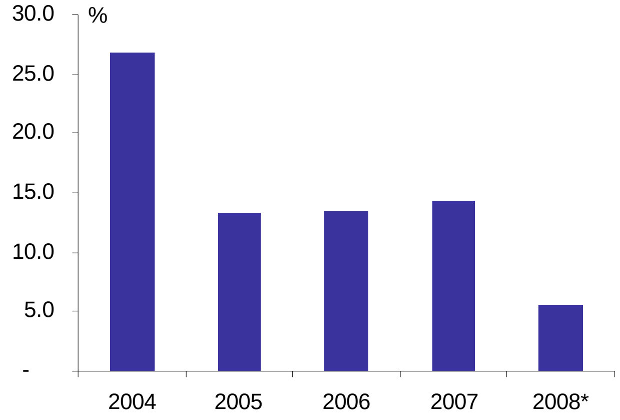
Tourist arrivals decline in Jan' 09; first in at least six years

Jan' 09 foreign arrivals declined 17.6% yoy; first such decline in at least past six years

Jan' 09 tourist arrivals at 0.49mn declined 17.6% yoy, the first such fall in at least six years. Although there is no direct co-relation between foreign arrivals and luxury room rates due to uneven distribution pattern (Andhra Pradesh receives less than 10% of arrivals), we believe reduced corporate demand from abroad would impact ARRs and occupancies in major recipient destinations such as Bangalore and Mumbai in FY10.

As mentioned in our earlier sector update in Jan' 09, overall arrivals may drop 10% over CY08-10, similar to that seen in 2001-02, post 9/11 attacks and recession in US.

Foreign arrivals in 2008 grew at slowest pace in 5 years



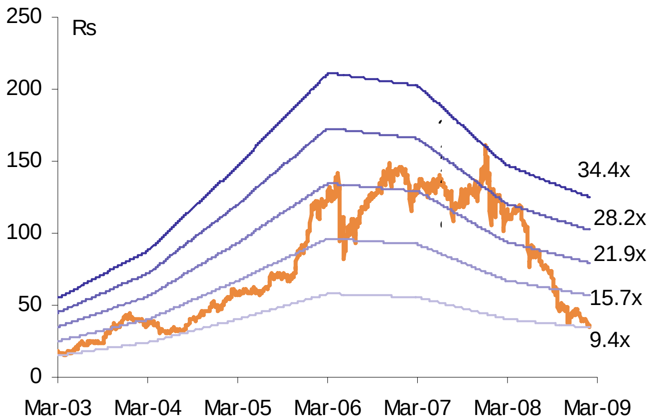
Source: India Infoline Research
** Provisional*

Indian Hotels may be relatively better placed

Indian Hotels trades at a 9.4x 1-year forward P/E, a five-year low

Indian Hotels presently trades at 9.4x its 1-year forward P/E, a five year low but we remain apprehensive of any near-term revival in demand that could support valuations. However, as compared to EIH, Indian Hotels may be better placed since the former trades at 25.3x FY10E earnings, a steep 162% premium to latter's FY10E multiples. Even on other valuation counts, such as P/BV, EIH appears expensive.

Indian Hotels 1-year forward P/E



Source: India Infoline Research

Indian Hotels Company Ltd - SELL

CMP Rs34, Target Rs30

Sector: Hotels	
Sensex:	8,198
CMP (Rs):	34
Target price (Rs):	30
Downside (%):	12.9
52 Week h/l (Rs):	124 / 34
Market cap (Rscr) :	2,492
6m Avg vol ('000Nos):	369
No of o/s shares (mn):	723
FV (Re):	1
Bloomberg code:	IH IB
Reuters code:	IHTL.BO
BSE code:	500850
NSE code:	INDHOTEL

Prices as on 05 Mar, 2009.

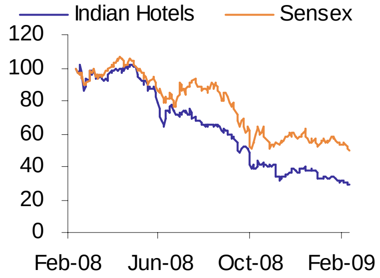
Shareholding pattern

December '08	(%)
Promoters	29.5
Institutions	43.7
Non promoter corp hold	5.5
Public & others	21.3

Performance rel. to sensex

(%)	1m	3m	1yr
Indian Hotels	(0.5)	(4.7)	(20.5)
EIH	10.3	(14.2)	12.0
Hotel Leela	(1.6)	(3.3)	(13.2)

Share price trend



ARRs may mark bottom in FY10; likely to fall 5-7%

We project a 5-7% fall in room tariffs for the company across major destinations in FY10 with occupancy levels of about 65-68%. Although we have revised marginally upwards our ARR estimates for the next year but maintain our view that room rates could mark a bottom in FY10. However, both revenues and profits have been toned down as company has frozen all uncommitted projects leading to lower room additions.

Margins to remain subdued over next two years

Operating margin reached a high of 30% in FY08 as ARRs attained their peak in the previous year. For the next two years, we expect margin to remain subdued and decline by ~775bps over FY08-10. A mitigating factor could be the geographic spread and positioning of brands at major price points from luxury ('Taj') to the budget ('Ginger') hotels.

Lack of volume growth beyond FY10

The company has frozen all uncommitted spending plans and even routine capex and would focus on accelerated completion of ongoing projects. As a result, several previously announced hotels such as those in Mumbai and Noida (Taj residency) have been put on the backburner. Indian Hotels would add just over 2,000 rooms in the next fiscal of which owned inventory would account for less than 30% of total.

Reduce PAT estimates on lower room additions; Retain SELL

We have reduced our FY10 revenue and PAT estimates by 5.4% and 4.6% respectively to account for lower room inventory additions than previously envisaged. This would be offset by lower equity dilution to the extent of 7.7%, as we assume deep out-of-money warrants may not be converted. Probably in lieu of this, the company has raised Rs3bn through the issuance of 11.8% privately placed NCDs in Q3 FY09.

The stock is trading at 9x its 1-year forward P/E, a five year low, but we remain skeptical of any immediate revival in demand which may support current valuations. Retain our SELL and cut target price by 11.8% to Rs30.

Valuation summary

Y/e 31 March (Rs m)	FY08	FY09E	FY10E	FY11E
Revenues	29,200	27,674	27,214	30,918
yoy growth (%)	16.5	(5.2)	(1.7)	13.6
Operating profit	8,920	6,946	6,205	7,327
OPM (%)	30.5	25.1	22.8	23.7
Reported PAT	3,550	3,096	2,582	3,293
yoy growth (%)	(4.1)	(12.8)	(16.6)	27.5
EPS (Rs)	5.9	4.3	3.6	4.5
P/E (x)	5.9	8.1	9.7	7.6
P/BV (x)	0.9	0.6	0.6	0.6
EV/EBITDA (x)	5.9	6.8	7.6	6.3
Debt/Equity (x)	1.5	0.8	0.8	0.7
ROE (%)	18.7	10.1	6.6	8.1
ROCE (%)	15.2	8.9	6.9	8.2

Source: Company, India Infoline Research

EIH Ltd - SELL

CMP Rs96, Target Rs48

Sector: Hotels	
Sensex:	8,198
CMP (Rs):	96
Target price (Rs):	48
Downside (%):	50.2
52 Week h/l (Rs):	175 / 74
Market cap (Rscr) :	3,784
6m Avg vol ('000Nos):	146
No of o/s shares (mn):	393
FV (Rs):	2
Bloomberg code:	EIH IB
Reuters code:	EIHO.BO
BSE code:	500840
NSE code:	EIHOTEL

Prices as on 05 Mar, 2009.

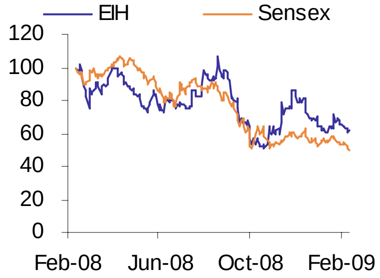
Shareholding pattern

December '08	(%)
Promoters	46.4
Institutions	17.8
Non promoter corp hold	22.8
Public & others	13.0

Performance rel. to sensex

(%)	1m	3m	1yr
EIH	10.3	(14.2)	12.0
Indian Hotels	(0.5)	(4.7)	(20.5)
Hotel Leela	(1.6)	(3.3)	(13.2)

Share price trend



Volume growth unlikely to offset ARR, occupancy decline

EIH is expected to commission its 437-room 'Trident' hotel in Mumbai, by April' 09. The property would impart volume growth in a difficult environment, but we believe, it is unlikely to offset the impact of ARR and occupancy decline across the portfolio. Post commissioning, Trident Mumbai is estimated to account for 21% of standalone room revenues in FY10. Overall, Mumbai properties would account for about 60% of its standalone room inventory in CY09.

Two-third revenues accrue from Mumbai and Delhi properties

Mumbai and Delhi properties would together account for approximately 66% of the company's FY09E standalone room revenues. This leaves the company vulnerable to the fluctuations of room rates in the two markets. With a depressed demand scenario, we believe Mumbai and Delhi would undergo a contraction in ARRs and occupancies over the next 12 months. For FY10, EIH is likely to witness a 3-4% drop in room tariffs in these two cities while occupancies may fall 300-500bps yoy.

Trades at a hefty premium to Indian Hotels

EIH trades at a hefty 162% premium to Indian Hotels' FY10E P/E of 9.7x. Admittedly, EIH has better earnings CAGR over FY09-11 and higher margins, but in our view, the valuations do not take in to account the concentrated nature of revenues and earnings accrued from a mostly city-based hotel portfolio. Also Indian Hotels is better positioned in terms of its geographic spread and presence across major price segments.

Lacks catalyst, valuations remain expensive; Retain SELL

In addition to the Trident Mumbai, EIH has signed management contracts for hotels in Hyderabad and Bangalore. Hence, lack of volume growth from owned properties beyond FY10 remains a key concern especially in the light of muted ARR growth in FY11. Valuations at 25.3x FY10E earnings remain far above sector average. We retain our SELL rating on the stock with a price target of Rs48.

Valuation summary

Y/e 31 March (Rs m)	FY08	FY09E	FY10E	FY11E
Revenues	11,580	9,885	10,928	13,353
yoy growth (%)	15.3	(14.6)	10.5	22.2
Operating profit	3,969	2,995	2,918	3,806
OPM (%)	34.3	30.3	26.7	28.5
Pre-exceptional PAT	2,249	1,525	1,495	2,101
Reported PAT	2,215	1,525	1,495	2,101
yoy growth (%)	12.2	(31.1)	(2.0)	40.5
EPS (Rs)	5.6	3.9	3.8	5.3
P/E (x)	17.1	24.8	25.3	18.0
P/BV (x)	3.0	2.9	2.7	2.5
EV/EBITDA (x)	11.8	16.6	16.9	12.8
Debt/Equity (x)	0.7	0.9	0.8	0.7
ROE (%)	19.0	11.9	11.0	14.4
ROCE (%)	20.4	14.6	13.3	16.5

Source: Company, India Infoline Research

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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