

INDIAN HOTELS

Positive surprise on ORs; US operations to turnaround in FY11E

■ Healthy growth in ARRr

Indian Hotels Company (IHCL) continued to surprise on the ORs, posting 76% in Q4FY10 against 64% in Q4FY09 - the highest in the past eight quarters, signaling a very healthy turnaround. The company was able to improve Q3FY10 ARRr of INR 9,558 by 2%. We believe during FY10, ARRr were down ~17% over FY09, at INR 8,700, against our expectations of 15%; ORs were, however, maintained at 65-66%. Considering improvement in operations, we raise our ORs estimates to 70% and 72% from 67% and 70% for FY11E and FY12E, respectively. We maintain our estimate of 10% rise in ARRr for FY11E and FY12E.

■ US operations to turnaround in FY11E

We reiterate our stand of the US operations turning EBITDA-positive in FY11E, as the recovery of The Pierre, New York, takes shape. Pierre recorded ORs and ARRr of 70% and USD 550, as on May 10, respectively. Management is focused on making the US operations cash-neutral in FY11 to stop any incremental flow from the Indian operations. We expect Pierre to report 60-65% and USD 650-700 ORs and ARRr in FY11, respectively.

■ Q4FY10 sales, EBITDA margins hitting the highs of Q3FY09

Adjusted for one-offs, Q4FY10 sales increased 32% and 2% Y-o-Y and Q-o-Q, respectively. Q4FY10 EBITDA margins of 32.4% are comparable to 34.5% and 36.3% margins of Q3FY10 and Q3FY09, respectively. With more hotels becoming operational in owned and management contract routes in FY11E, we expect operating leverage to aid margin improvement.

■ Stabilisation of debt; capex under control

With INR 38 bn and INR 26.5 bn debt on consolidated and net basis, respectively, and limited capex of INR 2.6 bn for FY11, IHCL does not need to raise any further debt for the next 18-24 months.

■ Outlook and valuations: Strong traction in business; maintain 'BUY'

With improvement in ARRr and ORs, cost containment exercise and dedicated efforts to turnaround the US portfolio, we believe the company is on a revival path. With limited capex, we expect the coverage ratio to improve going forward. We revise our EPS estimates to INR 4.0 and INR 7.0 for FY11E and FY12E, respectively, and target price to INR 125, valuing IHCL at EV/EBITDA of 12.7x and 8.6x for FY11E and FY12E, respectively. We maintain 'BUY' on the stock.

Financials (Standalone)

Year to March	Q4FY10	Q4FY09	% change	Q3FY10	% change	FY10	FY11E
Revenues (INR mn)	4,384	4,182	4.8	4,223	3.8	14,089	17,918
EBITDA (INR mn)	1,435	1,165	23.2	1,512	(5.1)	3,803	5,660
Net profit (INR mn)	599	382	56.5	649	(7.8)	1,531	2,508
Diluted EPS (INR)	0.8	0.5	56.5	0.9	(7.8)	2.1	3.5
Diluted P/E (x)						NM	25.3
ROAE (%)						(5.9)	8.7

May 26, 2010

Reuters : IHTL.BO

Bloomberg : IH IN

EDELWEISS RATING

Absolute Rating

BUY

MARKET DATA

CMP	:	INR 100
52-week range (INR)	:	118 / 56
Share in issue (mn)	:	723.5
M cap (INR bn/USD mn)	:	72.3 / 1,526.3
Avg. Daily Vol. BSE/NSE ('000)	:	2,677.5

SHARE HOLDING PATTERN (%)

Promoters*	:	29.5
MFs, FIs & Banks	:	28.6
FIIIs	:	13.9
Others	:	28.0
* Promoters pledged shares (% of share in issue)	:	1.4

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	(9.7)	(6.9)	2.8
3 months	(2.5)	13.8	16.3
12 months	17.9	63.1	45.2

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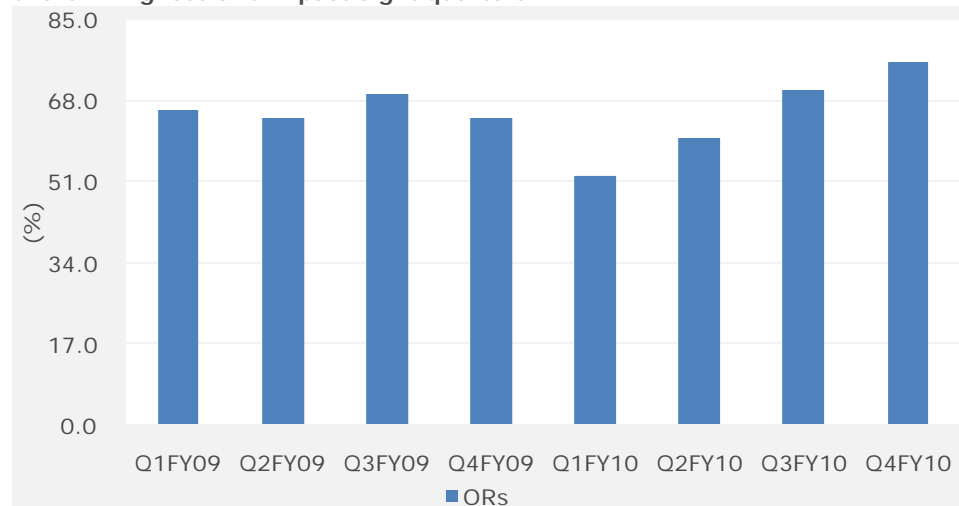
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■ Healthy growth in ARR

IHCL continued to surprise on the ORs, posting 76% in Q4FY10 against 64% in Q4FY09 - the highest in the past eight quarters, signaling a very healthy turnaround.

Chart 1: Highest ORs in past eight quarters



Source: Company, Edelweiss research

The company was able to improve the Q3FY10 ARR of INR 9,558 by 2%. We believe that during FY10, ARRs were down ~17% over FY09, to INR 8,700, but the company was able to maintain ORs at 65-66%.

Chart 2: Visible improvement in ARRs



Source: Company, Edelweiss research

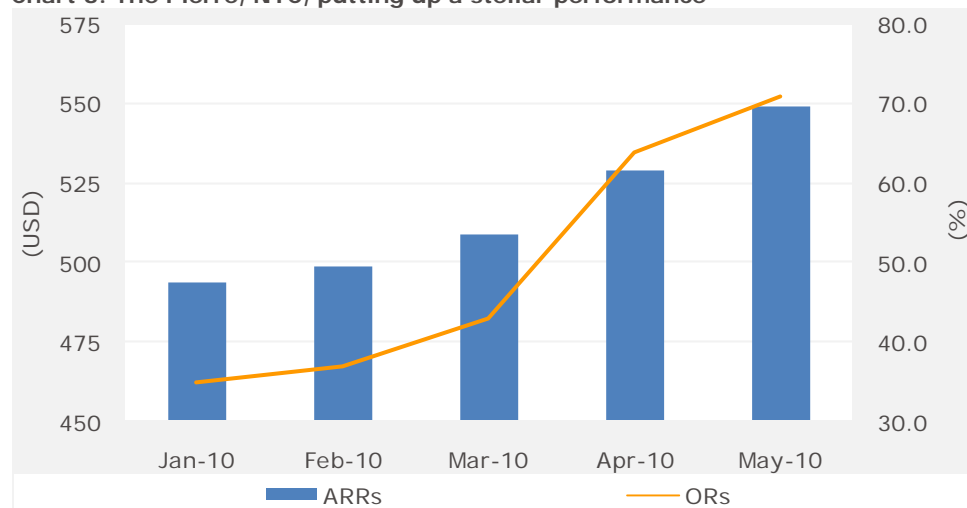
Considering the improvement in operations, we increase our ORs estimates to 70% and 72% from 67% and 70% for FY11E and FY12E, respectively. Moreover, we maintain our estimate of a 10% rise in ARR in both the years.

■ US operations to turnaround in FY11E

Above-average performance recorded by The Pierre, NYC, makes us believe that the US operations will turn EBITDA-positive in FY11E as recovery takes shape. Pierre has recorded 70% and USD 550 of ORs and ARRs, as on May 10, respectively. Management

is focused on getting the US operations cash-neutral in FY11 only to stop any incremental flow from the Indian operations.

Chart 3: The Pierre, NYC, putting up a stellar performance



Source: Company, Edelweiss research

We expect Pierre to report 60-65% and USD 650-700 ORs and ARR in FY11, respectively. EBITDA margins increased to 34.5% against 16.6% in Q2FY10 and 36.3% in Q3FY09.

■ Q4FY10 sales, EBITDA margins hitting the highs of Q3FY09

Adjusted for one-offs, Q4FY10 sales increased 32% Y-o-Y and 2% Q-o-Q. Q4FY10 EBITDA margins of 32.4% are comparable to 34.5% and 36.3% margins of Q3FY10 and Q3FY09, respectively. With more hotels becoming operational in owned and management contract routes in FY11E, we expect operating leverage to aid margin improvement.

■ Stabilisation of debt; capex under control

With INR 38 bn and INR 26.5 bn net debt on consolidated and net basis, respectively, and limited capex of INR 2.6 bn for FY11, IHCL does not need to raise any further debt for the next 18-24 months. Following are the number of rooms IHCL intends to add in FY11:

Table 1: Aggressive expansion on cards

Under IHCL	
Falaknuma, Hyderabad	60
Yeshwantpur, Bangalore	331
Under JV / Associate	
Cape town	172
Begumphet	175
Chennai	64
Coorg	62
5 Ginger	463
Under management contract	2,250
Total	3,577

Source: Company, Edelweiss research

As the Sea Rock asset has been transferred to an SPV, capex on that property is going to be off the books for the next three years. The company, on a standalone basis, intends to complete only the following projects:

Table 2: Focus only on the ongoing projects

Falaknuma, Hyderabad	60
Yeshwantpur, Bangalore	331
Dwarka	440
Guhati	65

Source: Company, Edelweiss research

It does not plan to start work on any green-field project in the next 18-24 months, before the coverage ratios start looking healthy.

Financial snapshot (Standalone)**(INR mn)**

Year to March	Q4FY10	Q4FY09	% change	Q3FY10	% change	FY10	FY11E	FY12E
Net sales	4,384	4,182	4.8	4,223	3.8	14,089	17,918	24,411
Other operating income	50	-		156	(68.0)	644	971	1,068
Total Income	4,433	4,182	6.0	4,379	1.2	14,733	18,889	25,479
Consumption of raw material	327	251	30.1	338	(3.2)	1,126	1,376	1,750
Staff costs	953	1,122	(15.1)	880	8.3	3,561	4,413	4,854
License fees	276	232	18.9	258	7.1	893	1,133	1,529
Fuel, light and power	251	221	13.7	249	1.0	1,000	1,133	1,529
Other expenditure	1,192	1,191	0.1	1,143	4.3	4,350	5,173	6,255
Total expenditure	2,998	3,017	(0.6)	2,867	4.6	10,930	13,229	15,916
EBIDTA	1,435	1,165	23.2	1,512	(5.1)	3,803	5,660	9,562
Depreciation	279	286	(2.5)	260	7.2	1,041	1,247	1,422
EBIT	1,157	879	31.5	1,252	(7.6)	2,762	4,413	8,141
Interest	332.9	229.4	45.1	441.8	(24.6)	1,529	1,618	1,658
Other income	85	122	(30.6)	36	133.2	437	949	913
PBT before exceptional items	908	772	17.6	847	7	1,670	3,744	7,395
Exceptional items - Income/(loss)	4.9	(11.6)	141.8	(7.7)	163.4	512	-	-
PBT	913	761	20.0	839	8.8	2,183	3,744	7,395
Tax	315	378	(16.8)	190	65.7	652	1,235	2,440
PAT	599	382	56.5	649	(7.8)	1,531	2,508	4,955
EPS	0.8	0.5	56.5	0.9	(7.8)	2.1	3.5	6.8
Diluted P/E (x)						NM	25.3	14.2
ROAE (%)						(5.9)	8.7	14.4

As % of net revenues

Raw Materials	7.5	6.0		8.0		8.0	7.7	7.2
Employee Expenses	21.7	26.8		20.8		25.3	24.6	19.9
Total Expenditure	68.4	72.1		67.9		77.6	73.8	65.2
EBITDA	32.7	27.9		35.8		27.0	31.6	39.2
Net profit	13.7	9.1		15.4		10.9	14.0	20.3
Tax rate	34.5	49.7		22.6		29.9	33.0	33.0

■ Company Description

IHCL is the largest hotel operator in India with presence in luxury, business and leisure hotel segments. The company manages 12,243 (103 properties) across India and international locations. The company has also entered into the budget hotel segment with a new brand, 'Ginger' and has also gone into the adventure business with wildlife lodges. IHCL also runs airline catering business under the brand of Taj SATS, which contributes 6-7% of the total sales. The company has aggressive plans of expansion, both in India and international by using ownership and asset light model of management contract.

■ Investment Theme

With the revival of ARR and ORs across India, hotel industry is looking for better times ahead. With India emerging as one of the fastest growing economy, FTAs of both business and leisure is expected to pick-up. Domestic tourism is also on a great revival path and with more Indians ready to take holidays, is expected to perform well in the years to come. We expect IHCL's Indian portfolio (forming almost 80% of total sales) to post healthy growth with the revival of domestic ARR and ORs. We also expect the international operations to turnaround and start contributing significantly to the overall margins.

■ Key Risks

Economic slowdown is the biggest risk for the company as travel and tourism takes the first knock in uncertain times. Unexpected events like terrorist attack or swine flu also affects the industry badly as many countries advise its citizens against traveling to those affected parts. The company can continue to earn negative returns on its international investments due to longer than expected turnaround of international operations and the stake of Orient Express (OEH).

Financial Statements (Consolidated)

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	29,200	26,800	25,165	32,262	40,345
Total operating expenses	20,280	21,744	21,229	22,943	27,131
Employee cost	7,644	8,552	8,442	8,988	9,702
F&B	2,782	2,772	2,547	3,226	4,034
Power & fuel	1,547	1,677	1,723	1,774	2,219
Other expenditure	8,307	8,743	8,517	8,955	11,175
EBITDA	8,920	5,056	3,936	9,319	13,214
Depreciation and amortisation	1,676	1,885	2,185	2,465	2,636
EBIT	7,244	3,171	1,751	6,854	10,578
Interest	2,203	2,711	3,061	3,498	3,758
Total other income	1,106	1,111	322	764	646
Profit before tax	6,147	1,571	(988)	4,121	7,466
Provision for tax	2,426	1,520	847	1,360	2,464
Core profit	3,720	51	(1,835)	2,761	5,002
Extraordinary income/(loss)	(542)	-	606	-	-
Profit after tax	3,179	51	(1,230)	2,761	5,002
Minority interest	(414)	(97)	(139)	(97)	(97)
Profit after minority interest	3,593	148	(1,369)	2,858	5,099
Shares outstanding (mn)	603	723	723	723	723
EPS (INR) basic	6.9	0.2	(2.3)	4.0	7.0
Diluted shares (mn)	603	723	723	723	723
EPS (INR) diluted	6.9	0.2	(2.3)	4.0	7.0
Dividend per share (INR)	1.9	1.2	1.0	1.0	1.0
Dividend payout (%)	0.4	7,636.1	(8,681.0)	30.7	16.9

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating expenses	69.5	81.1	84.4	71.1	67.2
Employee cost	26.2	31.9	33.5	27.9	24.0
Other expenditure	28.4	32.6	33.8	27.8	27.7
Depreciation and amortisation	5.7	7.0	8.7	7.6	6.5
Interest expenditure	7.5	10.1	12.2	10.8	9.3
EBITDA margins	30.5	18.9	15.6	28.9	32.8
Net profit margins	12.7	0.2	(7.3)	8.6	12.4

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	16.5	(8.2)	(6.1)	28.2	25.1
EBITDA	23.8	(43.3)	(22.2)	136.8	41.8
PBT	15.4	(74.4)	(162.9)	516.9	81.2
Core net profit	10.6	(98.6)	(3,677.8)	250.4	81.2
EPS	11.5	(97.0)	(1,242.3)	268.5	78.4

Balance sheet**(INR mn)**

As on 31st March	FY08	FY09	FY10E	FY11E	FY12E
Equity capital	603	723	723	723	723
Preference share capital	-	1,200	1,200	1,200	1,200
Reserves & surplus	22,088	31,056	30,199	32,064	36,220
Shareholders funds	22,691	32,979	32,123	33,987	38,143
Secured loans	16,316	26,596	30,596	29,596	24,596
Unsecured loans	18,353	19,873	19,873	19,873	19,873
Borrowings	34,668	46,469	50,469	49,469	44,469
Minority Interest	2,820	2,741	2,116	2,116	2,116
Deferred tax (net)	1,485	1,602	977	977	977
Sources of funds	61,665	83,790	85,684	86,549	85,705
Gross block	46,465	53,924	61,586	68,126	70,626
Depreciation	11,321	13,041	15,235	17,700	20,336
Net block	35,144	40,883	46,350	50,426	50,290
Capital work In progress	4,352	7,273	1,273	1,273	1,273
Intangible assets	2,970	3,612	3,612	3,612	3,612
Investments	15,419	24,077	21,582	19,825	19,825
Long term deposits	1,421	1,628	1,628	1,628	1,628
Inventories	533	641	542	619	663
Sundry debtors	2,079	1,778	1,694	2,210	2,763
Cash and bank balances	2,576	2,529	2,548	1,307	1,033
Loans and advances	3,662	8,865	13,165	13,165	13,165
Total current assets	8,850	13,812	17,948	17,300	17,625
Sundry creditors and others	5,722	5,556	4,852	5,657	6,690
Provisions	861	2,015	2,015	2,015	2,015
Total current liabilities & provisions	6,583	7,570	6,867	7,672	8,704
Net current assets	2,267	6,242	11,082	9,628	8,920
Misc expenditure	92	76	76	76	76
Uses of funds	61,665	83,790	85,684	86,549	85,705
Book value per share (BV) (INR)	31	44	43	45	51

Free cash flow**(INR mn)**

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Net profit	3,593	148	(1,369)	2,858	5,099
Depreciation	1,676	1,885	2,185	2,465	2,636
Others	1,874	2,397	4,425	2,827	3,204
Gross cash flow	7,144	4,431	5,241	8,149	10,940
Less: Changes in working capital	(79)	1,297	520	(212)	(434)
Operating cash flow	7,222	3,134	4,720	8,362	11,375
Less: Capex	(6,820)	(8,623)	(3,662)	(6,540)	(2,500)
Free cash flow	403	(5,489)	1,058	1,822	8,875

Cash flow metrics

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Operating cash flow	7,222	3,134	4,720	8,362	11,375
Financing cash flow	10,334	17,230	(724)	(5,344)	(9,604)
Investing cash flow	(16,752)	(19,619)	(4,770)	(4,259)	(2,044)
Net cash flow	805	746	(774)	(1,241)	(273)
Capex	(6,820)	(8,623)	(3,662)	(6,540)	(2,500)
Dividend paid	(1,165)	(1,016)	(846)	(846)	(846)

Ratios

Year to March	FY08	FY09	FY10E	FY11E	FY12E
ROAE (%)	17.1	0.2	(5.9)	8.7	14.4
ROACE (%)	16.7	6.0	2.8	10.5	16.0
Inventory (days)	6	8	9	7	6
Debtors (days)	26	26	25	22	22
Payable (days)	93	95	89	84	83
Cash conversion cycle	(61)	(60)	(56)	(55)	(55)
Current ratio	1.3	1.8	2.6	2.3	2.0
Debt/EBITDA	3.9	9.2	12.8	5.3	3.4
Interest cover (x)	3.3	1.2	0.6	2.0	2.8
Fixed assets turnover (x)	0.8	0.7	0.5	0.6	0.8
Total asset turnover (x)	0.5	0.4	0.3	0.4	0.5
Equity turnover(x)	1.3	1.0	0.8	1.0	1.2
Debt/Equity (x)	1.5	1.4	1.6	1.5	1.2
Adjusted debt/Equity	1.5	1.4	1.6	1.5	1.2

Du pont analysis

Year to March	FY08	FY09	FY10E	FY11E	FY12E
NP margin (%)	12.7	0.2	(7.3)	8.6	12.4
Total assets turnover	0.5	0.4	0.3	0.4	0.5
Leverage multiplier	2.5	2.7	2.7	2.7	2.5
ROAE (%)	17.1	0.2	(5.9)	8.7	14.4

Valuation parameters

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Diluted EPS (INR)	6.9	0.2	(2.3)	4.0	7.0
Y-o-Y growth (%)	11.5	(97.0)	(1,242.3)	68.5	78.4
CEPS (INR)	8.0	2.8	0.7	7.4	10.7
Diluted P/E (x)	14.6	487.1	NM	25.3	14.2
Price/BV(x)	3.2	2.3	2.3	2.2	2.0
EV/Sales (x)	2.6	3.4	3.9	3.1	2.4
EV/EBITDA (x)	8.6	18.2	25.1	10.8	7.3
EV/EBITDA (x)+1 yr forward	15.2	23.4	10.6	7.6	6.2
Dividend yield (%)	1.9	1.2	1.0	1.0	1.0

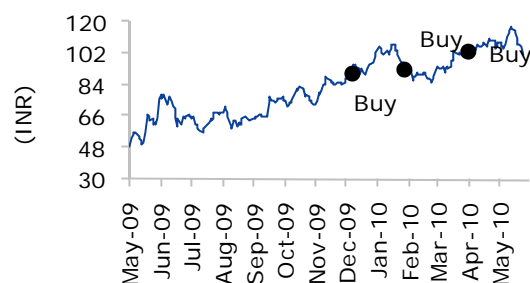
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Coverage group(s) of stocks by primary analyst(s): Hotels

Cox & Kings, EIH, Hotel Leela Venture, Indian Hotels Company and Mahindra Holidays & Resorts India.

Indian Hotels



Recent Research

Date	Company	Title	Price (INR)	Recos
25-May-10	Hotel Leela Venture	Low base effect <i>Result Update</i>	49	Reduce
30-Apr-10	Mahindra Holidays Resorts	Membership addition slowing down; <i>Result Update</i>	500	Reduce
05-Apr-10	Hotels & Tourism	Room for growth; <i>Sector Report</i>		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	101	56	9	109

* 3 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	53	13

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	depreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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