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Lemon Tree: why room for expansion in valuation multiples looks limited

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Lemon Tree Hotels Ltd operates in the so-called mid-priced segment, but its valuations are of the premium variety. The stock trades at an EV/Ebitda multiple of almost 32 times, according to HDFC Securities Institutional Research's estimates for FY20. EV stands for enterprise value and Ebitda is earnings before interest, tax, depreciation and amortization.

High valuations apart, operating performance hasn't kept pace lately either. The company's March quarter results were disappointing. Average daily rates (ADRs) realized on its hotel rooms increased only 4% year-on-year, missing Street expectations. For perspective:

ADRs had increased by 8.5% year-on-year for the nine months ended December.

The hotel chain suffered due to the overall slowdown in consumption in the economy. Secondly, the collapse of Jet Airways (India) Ltd meant higher airfares, adversely affecting passenger traffic volumes. Plus, there was some softness in corporate travel in the run-up to the general elections. Despite this, Lemon Tree managed to improve its occupancy rates marginally to 77.6%. A basis point is 0.01%.

But this evidently came at the cost of realizations, which is

reflected in the drop in ADR growth rates.

Overall, the company's revenue increased by 14% to ₹150 crore, while pre-tax and one-time profit rose at a slightly slower pace of 12.6% to around ₹15 crore.

Kotak Institutional Equities has revised downwards earnings for FY20 by 11%, though it added that inclusion of new projects in the management portfolio as well as higher ADRs for

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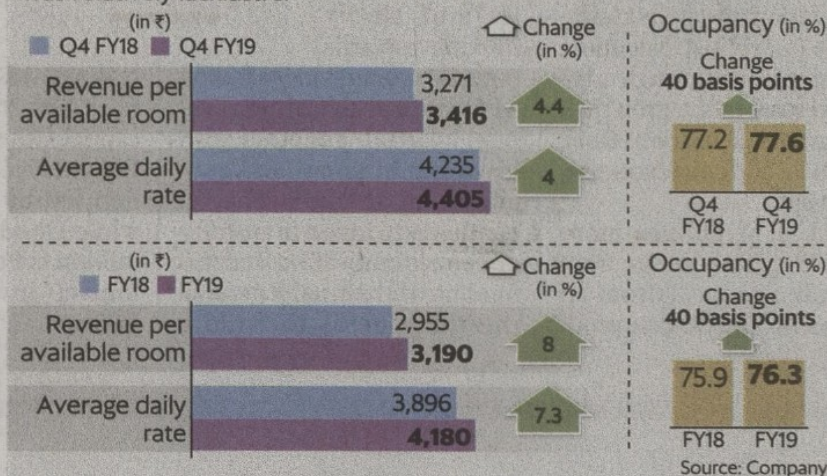
Mumbai properties leads to upward revision of 14% in FY21 earnings.

The company said its Pune property, launched at the end of the March quarter, should reach steady state over the next few quarters. It is also expected to launch a 303-room Mumbai hotel in June this year. "We have a large supply of high value inventory getting operationalized in demand dense regions with high occupancies which will help augment our ADRs," said Lemon Tree in its presentation.

As on 15 May, Lemon Tree had a portfolio of 5,525 rooms across 56 hotels. Hereon, investors will watch for improvement in ADRs closely. Until that happens, it is likely that valuations would remain in check especially given that they are already pricey. Plus, they also need to keep an eye on the impact on margins caused by the addition of new properties.

Room for growth?

Lemon Tree's average daily rate growth for the March quarter was relatively lacklustre.



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