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Hotel stocks order room service: See strong Q1, a stronger outlook

Inbound tourism, higher occupancies, and lean cost model are positives for listed hospitality majors

RAM PRASAD SAHU
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Hotel stocks have been among the largest sectoral gainers over the past month, riding on strong April-
1 June quarter (first quarter, or Q1) results of 2022-23 (FY23) and improving outlook ahead of the peak season.

While the scrip of the largest listed player in this space — Indian Hotels Company (IHCL) — was up 17 per cent, its smaller peers EIH (formerly East India Hotels) and Lemon Tree Hotels gained between 13 per cent and 18 per cent.

Among larger players, Chalet Hotels was the only outlier — it was down 7 per cent over this period.

Better prospects for the sector rests on three deliverables. Improved demand and higher occupancies in the domestic business, rebound in foreign travel, and limited competition for existing players, given the supply of rooms falls behind demand, which, paired with rising room rates, offers better pricing power.

Domestic demand has been strong, helping the sector improve its pre-pandemic metrics. With leisure continuing to do well and bounce-back in corporate travel, hotel majors were able to raise prices.

Revenue for the sector in Q1FY23 was up 25 per cent on the back of a 20-25 per cent increase in average room rates. The other gain has been on the operating profit margin front, with corporates adopting a leaner cost structure.

The reported operating profit margin of 30.3 per cent for Q1FY23 for the sector is among the highest in the past decade, point out equity research analysts Rashesh Shah and Debotro Sinha of ICICI Securities (ISec).

REVENUE SURPASSES PRE-COVID LEVELS

	(₹crore)	% change		
	Q1FY23	YoY	QoQ	over Q1FY20
Indian Hotels	1,266	267	45	24
EIH	394	311	31	16
ITC*	555	336	42	41
Chalet Hotels	253	274	71	5
Lemon Tree	192	356	61	36

* Hospitality segment; Consolidated figures

Source: *Motilal Oswal Research*

They expect over 12-15 per cent reduction in operating costs from pre-pandemic levels, helping companies scale up margins. About 70 per cent of the total cost of the hospitality industry is fixed in nature, with power/lighting and employees accounting for a sizeable portion.

The uptick in foreign tourist arrivals could enliven the overall prospects of the sector. Foreign tourists during the January-July period were 55 per cent lower, compared with the comparable months for the pre-pandemic period in 2019.

Say research analysts Sumant Kumar and Meet Jain of Motilal Oswal Research, "Domestic demand is witnessing strong recovery, while international travel is a straggler. With pick-up in foreign inbound travellers in the December and March quarters, combined with resilient domestic demand, the second half (H2) of FY23 is expected to be significantly better."

Typically, the H2 of any financial year (October-March) is seasonally strong, accounting for 60 per cent of the sector revenues.

The other factor that should assist existing hotel majors is a muted supply pipeline. Hotelivate, a hospitality consulting firm, expects supply to be inmid-single digits over the next five years — tepid compared to history.

With demand expected to be strong and occupancies moving closer to 70 per cent over the next few years (2021-22 at 50 per cent), room rates are expected to see an increase, observes Hotelivate.

The new-age hospitality consulting firm also highlighted that hotels have clocked their best performances ever for several markets in July and August, and business on the books is robust across markets.

Given these factors, Jefferies Research believes the hospitality industry is experiencing improving fundamentals, with demand growth expected to outstrip supply in the near to medium term.

Among listed stocks, IHCL is the top pick of most brokerages, followed by Lemon Tree Hotels. Along with these two, ISec is also upbeat on EIH and Easy Trip Planners.

In addition to their presence in the luxury and mid-scale hotel segment, IHCL and EIH are well placed on the balance-sheet front, given the fund raising of ₹4,000 crore (IHCL) and ₹350 crore (EIH). This should enable them to expand their market share, says ISec.

While Lemon Tree is more leveraged than peers, it has strong potential to grow faster than larger peers, supported by strong institutional backing for liquidity support.

Air travel recovery, strong balance sheet, and expansion into the non-air segment are the key triggers for Easy Trip Planners, says the brokerage.

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