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Lemon Tree can ride high on expansion amid improved demand

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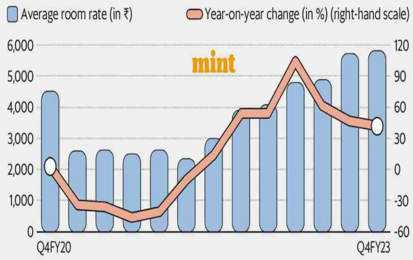
The recovery of corporate travel and an uptick in lei-
1 sure travel demand over the past one year has held hotel companies, including Lemon Tree Hotels in good stead. Lemon Tree has ended FY23 on a strong note with average room rate (ARR) touching a multi-quarter high of ₹5,824 during March quarter (Q4FY23) on the back of a significant increase in revenue per available room. ARR was up nearly 2% sequentially and 29% higher than Q4FY20 levels. Last quarter, occupancy rate was robust at 73.6%, clocking a meaningful increase from 67.6% in Q3.

The company's management is upbeat and has laid out a roadmap for five years. This should help boost ARRs and occupancies. Lemon Tree intends to expand rapidly at negligible cost in an asset-light model. By 2028, it sees its portfolio at over 300 hotels with more than 20,000 rooms (operational and pipeline). Out of this, over 70% will be managed and franchised and rest will be owned rooms. As on 31 March, Lemon Tree had 8,382 rooms (operational) and 3,285 (pipeline). In the next five years, the company aims to be debt free.

Good view

Lemon Tree Hotels' average room rate increased to a multi-quarter high in Q4FY23.



Source: Company, Motilal Oswal Financial services

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Over the long term, Lemon Tree intends to maintain earnings before interest, tax, depreciation, and amortization (Ebitda) margin at 50%. In Q4, Ebitda margin stood at 55.7%. In FY24, Lemon Tree will be investing a lot more in renovating its hotels, especially Keys portfolio. This will increase operating expenses by a further 2-2.5% of revenue in FY24, the company said. After renovations, management expects significant improvement in ARR and occupancy in H2FY24.

Further, commercialization of Aurika Sky City Mumbai is expected in Q3FY24. "Even if Aurika commences in Q3FY24, despite being a high margin portfolio, its benefit will get reflected from FY25 onwards, because initially there will be some costs associated with launch and occupancy has to improve. So even if ARR and occupancy improve in H2 (business period for hotel industry), Ebitda margins will be lower in FY24," said Kaustubh Pawaskar, deputy VP, research, Sharekhan by BNP Paribas.

To be sure, favourable demand in hotel sector could continue in FY24. Amid this, Lemon Tree's shares have risen 31% in past one year, capping meaningful upsides hereon. "Incremental improvement in ARRs and occupancy hereon would be more gradual, although contribution from Aurika in Mumbai from FY2025E will likely see a step-up in blended room rates," said a Kotak Institutional Equities report on 2 June.

Display: 2/2