# Check-in!

PHOTO: SANJAY BORADE

**Post IPO, Chalet Hotels is expanding its geographical footprint to cash in on the upcycle in the luxury hotel category**

*Sethi: branding with the best*

Three months ago, in February 2019 Chalet Hotels Ltd (CHL) hit the bourse with a higher side of the price band of ₹280 per share. Now the share is traded at ₹336, up 20 per cent accounting for a market cap of over ₹6,800 crore. Through the public offer CHL collected ₹1,670 crore, of which ₹950 crore was the initial public offer (IPO) and the balance was secondary sale by the promoters, who now hold close to 71 per cent.

"We expect the current upcycle to last longer and have higher peak occupancies than the previous one, and we see pricing growth returning in 2019 after a decade. With valuations attractive, too, we think it is a good time to own luxury hotel plays," states a Morgan Stanley report initiating a 'buy' on Chalet in March 2019.

According to the Morgan Stanley report India's hotel industry is just emerging from a long down cycle, in which occupancies sank from 73 per cent at the peak of the previous up cycle (FY08) to 59 per cent at the bottom of the cycle (FY16). "We are currently in the early stages of an upcycle, in which occupancies have improved to 66 per cent (FY16-19), as demand growth has outstripped weak supply growth. Incrementally, we expect the upcycle to continue at least until FY23, as the outlook for supply growth remains benign, and we expect pricing growth to re-commence gradually, as well. We put an 'Attractive' industry view on 'India Hotels', as an industry category," says the report, looking at hotel penetration in India at one of the lowest among key regions globally, at 1.2 rooms per 1,000 people versus 12.6 in China and 16 in the US.

For investors, Chalet was a new investment avenue backed by a sound set of promoters. As part of the CL Raheja's K Raheja Corp's business vertical run by the sons Ravi and Neel, these are owners, developers and asset managers of high-end hotels in key metros in India. The Raheja's real estate/retail pedigree comes from decades of experience in commercial (Mindspace), residential (the marquee Viveria and others) and retail (Inorbit, Shoppers Stop etc).

All these activities of the group and its strength as a construction company, architects and designers, bear an influence on the growth of CHL. It has helped to develop, refurbish and maintain hotels at optimal cost and quality. For example, with the hotel project management and design team, working together with the K Raheja Corp group and leveraging the experience of K. Raheja Companies' design teams to develop hotels it has lowered the capital cost. The average development cost per room (including the cost of land), for the luxury hotel at Sahar, Mumbai, which was completed in FY15 was ₹1.39 crore. In fact, the Sahar property has recently opened a food & beverage hub with tenants like Starbucks, Dragon Fly, Asian Cuisines, to name a few, to open soon.

Today, CHL's portfolio comprises of five operating hotels, including a hotel with a co-located serviced residence, located in Andheri (Mumbai), Hyderabad and Bengaluru, with an aggregate of 2,328 keys, up from 473 in 2001.

"Our hotels are branded with globally recognised hospitality brands and are in the luxury-upper upscale and upscale hotel segments," explains Sanjay Sethi, MD and CEO, who has three decades of experience in the hospitality industry, including with leading Indian hotel chains, as COO of ITC, Bergguren Hotels and Indian Hotels. In addition, CHL has developed commercial and retail spaces, in close proximity to some of its hotels. "We have developed our hotels at strategic locations generally with high barriers-to-entry and in high density business districts of their respective metros," adds Sethi pointing out, for example, the hotel in Sahar, Mumbai and another located across 15 acres at the banks of Powai lake, both are in proximity to Mumbai's international airport. Similarly, the hotel in Vashi, Navi Mumbai is located close to new business districts and the proposed international airport. The hotels in Hyderabad and Bengaluru are located near the offices of major technology corporations, business centres and retail and commercial facilities.

CHL generally develops hotels on large land parcels, allowing it to house a greater number of rooms, as well as provide a wide range of amenities, such as, fine dining and specialty restaurants, large banquet and outdoor spaces, targeting the luxury-upper upscale and upscale hotel segments "at an efficient gross built-up area and development cost per key. We believe we have a competitive advantage in key metro cities due to the significant time outlay required to build and establish a profitable hotel or commercial project, our early mover advantage in large, mixed-use developments in specific micro-markets and availability of unutilised land at certain of our hotel properties to further expand our operations, among others," says Sethi, who as a strategy seeks to brand the hotels with leading global hospitality brands. "This allows us to save on time and cost required to build, develop and maintain our 'own hotel brand' in the marketplace". Currently, CHL is branded with global brands such as JW Marriott, Westin, Marriott, Marriott Executive Apartments, Renaissance and Four Points by Sheraton which are held by Marriott Hotels India Private Limited. The contract terms with the brands generally ranging from 10 to 20 years.

### Active asset management

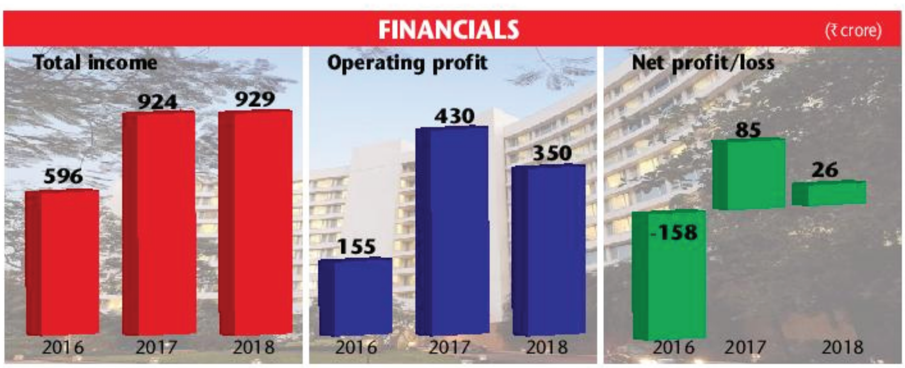
CHL also follows an active asset management model for the hotels. "These agreements give us access to Marriott's management expertise, industry best practices, online reservation systems, marketing strategies, systems and processes, human resources and operational know-how. Our active asset management model entails that in addition to contractual obligations under agreements with Marriott, we closely monitor, exercise regular oversight and contribute to the performance of our hotel properties," observes Sethi, who prides on the premium location of hotels, large room inventory and large function spaces, together with relationship with international hospitality brands, as factors that enable him to attract a target customer base including large corporate accounts such as information technology companies, airlines, multinational corporations, consultancy firms and banks.

"Our business model, which is brand agnostic, translates into a true strategic business advantage. It enables us to see more, touch more and collaborate with more partners across the hospitality landscape. From a finance perspective, it gives you the flexibility and insulates us from putting all our eggs in one basket whilst continuing to invest in value creating opportunities," says Rajeev Newar, executive director & CFO, CHL, who has seen the company grow at a CAGR of 25 per cent from FY16 to half-year ended September 2018. During this period, CHL logged a revenue of ₹596 crore (2016) to ₹929 crore (2018) and ₹497 crore (for the six months ended September 2018. The operating profit (EBIDTA) during the same period, doubled from ₹155 crore (2016) to ₹350 crore (2018) and ₹130 crore (September 2018).

"Our IPO has helped us de-leverage our balance sheet and create a headroom for growth. We have paid off over ₹100 million of debt, which has reduced our interest expense by almost ₹10 million. We have thus created the headroom and keeping the gunpowder dry for exploring accretive value investments in the hospitality space that could be suitably leveraged to create stakeholder value. Our focus is making sure that we are growing at the right pace at the right location. Most industry pundits believe that this industry is beginning to see an upcycle and we are well-positioned to leverage this opportunity," adds Newar.

"Chalet Hotels is a 15 per cent plus IRR story and the best play in the Indian hospitality space. Our comfort on Chalet stems from its unique positioning and efficient asset management strategy: the industry is coming out of a 10-year lull and we find it prudent to back asset owners (over brand owners) in an upcycle – superior EBITDA case in point, high and stable occupancy as its hotels are based in core business locations, expanding portfolio of high-end hotels with mixed-use development (hospitality, retail and commercial properties creating demand for each other). CHL's business transcends beyond just hospitality. The advantage of being a K Raheja group company and leveraging on its domain expertise brings non-linearity of margins," states an Axis Capital report on the company, which recommends a 'buy' with a target price of ₹410.

Meanwhile, according to JM Financials' market report, the number of chain-affiliated hotel rooms in India grew from 23,751 (March 2001) to 135,232 (March 2018). This was



*The CHL team: key to success*

primarily led by a strong business period from FY05 through the beginning of FY09, then some 18,500 rooms were added in FY10 and FY11. Incremental additions moderated to 11,000 rooms per year for the next four years and slowed thereafter to just below 9,400 rooms per year for the next three. "Room supply in the upscale segment picked up after FY11. As much as 14,000 rooms were added in this segment from FY11 to FY16 (a CAGR of 12.5 per cent), while supply was delayed on account of the longer development cycle in India. Hotel projects initiated during FY07-09 were completed during FY12-15. Further, the slowdown from end-2008, and particularly after 2010, caused several projects to be dropped. Going forward, inventory creation is expected to be slow, particularly in the luxury-upper upscale as fewer projects were taken up in the last 3-4 years. However, several new projects have been initiated recently, which may be completed in FY22 or later."

Bridging the gap, CHL has three hotel projects (588 keys) and two commercial projects 1.12 million square feet (msf) in the pipeline. Upcoming hotels are located in Hyderabad (178 keys), Airoli, Navi Mumbai (260 keys) and Powai, Mumbai (150 keys). "Westin in Hyderabad is expected to be opened by April 2021 while other projects are expected to be operational by September 2021. Commercial portfolio has two projects in the pipeline with a total built-up area of 1.12 msf: an IT building in Bengaluru (0.43 msf) and an office block in Powai (0.69 msf); these are expected to be operational by September 2021," says Sethi. The commercial buildings in Bengaluru and Mumbai are expected to yield a rent of ₹45/sf and ₹125/sf respectively.

### Cconsolidation

For the future, the Raheja management also intends to focus on developing new hotel-led mixed-use projects in prime locations with development sizes similar to existing projects, and which feature a combination of hotels, retail developments and commercial office space. "Our retail and commercial space under construction is expected to generate regular rental income and cushion the hospitality cash flow cyclicality. Retail and commercial spaces are also expected to complement the hospitality business and generate synergies within the hotel led mixed-use projects," points out Newar. For example, the development of commercial and retail real estate projects near the hotels will benefit the hotel business for MICE (meetings, incentives, conferences and events) will drive room occupancy.

According to the Horwath Report, the luxury-upper upscale hotel segment is expected to witness a growth in the MICE segment. "We believe that given CHL's presence in key metros and size of our hotels, including large-sized banquet, outdoor and conferencing facilities, particularly at our hotel at Sahar, Mumbai and at our hotel and convention centre at Powai, Mumbai, we are well-positioned to benefit from the growth potential in the MICE segment, facilitating both domestic and international business meetings and conferences. We believe, the technology and facilities available at our properties in addition to their locational advantage will allow us to capture the expected growth in this segment," adds Sethi.

Another important aspect the Horwath report adds is that the hospitality industry in India has recently experienced some consolidation. The hotel industry has seen considerable debt-related stressed assets, including projects that are left incomplete or completion prolonged due to lack of funding which creates acquisition opportunities, for other players. "Post the equity issue, Chalet's net debt to EBITDA ratio has declined from 8.5 times in FY18 to 4.2 times in FY19. Going forward, ramp up in the ARR (average room rate)/occupancy and incremental revenue/EBITDA from Sahar commercial and retail operations will help Chalet pare down debt. We believe, Chalet is well placed to capitalise on acquisition opportunities arising in the hotel industry," states the JM Financial report.

"We will explore opportunities for acquiring operating hotel assets. We seek to leverage our experience and in-house capabilities to acquire operational or near complete hotel assets at an attractive price to reduce replacement cost, initiate turnaround strategies through active asset management, brand repositioning, property enhancement or cost controls and derive benefits of economies of scale. We believe that our asset ownership model allows us the flexibility to acquire a variety of existing branded hotels unlike hotel companies which operate under their own brand," sums up Sethi, who plans to evaluate inorganic growth opportunities, grow market share and consolidate market position in strategic micro-markets in key metro cities besides expand CHL's portfolio to newer geographies across India traffic from business and leisure travellers particularly in the NCR, Bengaluru, Pune, Chennai and Goa.

◆ LANCELOT JOSEPH

lancelot.joseph@businessindiagroup.com