Hotels Demand to Continue to Outstrip Supply, RevPAR to Grow at 8-9% in FY25

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Synopsis

- The Indian hospitality sector is currently experiencing an upcycle, driven by favorable demographics, robust domestic demand (with supply clearly lagging behind demand growth), increased investments, and ongoing improvements in infrastructure and connectivity. According to CareEdge's estimates, the industry's Revenue Per Available Room (RevPAR) registered a strong growth of 14% during fiscal year 2024. For FY25, RevPAR is expected to grow by approximately 8-9%, building on the high base set in FY24.
- India currently has around 166,000 branded hotel rooms/keys. Over the next five years, the industry is expected to add approximately 55,000 rooms, with supply registering a Compound Annual Growth Rate (CAGR) of 4.5-5.5% during this period.
- The segment mix is shifting towards Upper Midscale and Midscale Economy, with more than 60% of new supply expected to be added in these segments. This growth is driven by several factors, including a growing middle class, a significant uptick in business travel (especially from small and medium-sized enterprises (SMEs)), and an expanding scope of business activities into Tier 2, Tier 3, and Tier 4 cities. More than 70% of the proposed new supply is concentrated in Tier 2 and Tier 3 cities, followed by Tier 1, as hotel owners and operators explore opportunities to capture unmet demand in emerging and underserved markets.
- The industry dynamics have significantly shifted, with more investors exploring asset-light options to increase revenue and margins without significant capital expenditure.

Capacity additions on the rise, however lagging the demand growth

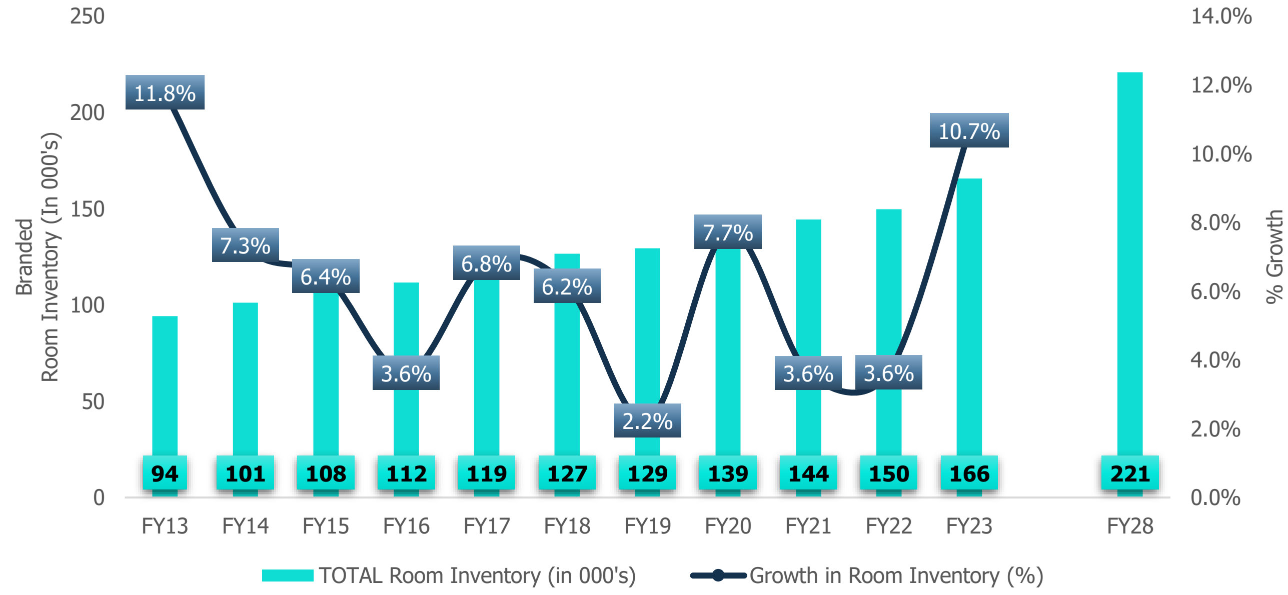
The growth registered by hoteliers over the past two years, along with a positive industry outlook supported by strong domestic tourism (especially leisure tourism), a gradual recovery in foreign tourist arrivals (FTAs), and a continuous rise in business travel driven by Meetings, Incentives, Conferences, and Exhibitions (MICE) events, is expected to drive an increase in room capacity additions over the medium term.

Over the past five years, India's travel and tourism sector has contributed approximately 5% to the country's total Gross Domestic Product (GDP), with still relatively low penetration. With the Indian government's emphasis on the sector, the travel and tourism industry is projected to grow by 8-9% annually, reaching a total value of USD 500-530 billion by FY34, according to the Ministry of Tourism. Rising urbanization in several Tier 2 and Tier 3 cities will further drive demand for hotels across different segments.

Considering these factors, the hospitality industry is expected to see robust room additions in the coming years. However, in the medium term, supply growth is expected to lag behind demand growth, thereby supporting key operating metrics for hoteliers.

In FY21, capacity additions hit a multi-year low as the hospitality industry came to a near standstill due to the outbreak of COVID-19. This led to a significant decline in revenue and losses due to the decrease in both domestic and international travel. The poor financial condition of industry players, coupled with uncertainty surrounding the resumption of travel, delayed the completion of projects under implementation in FY21, and capex plans were largely halted. However, with operational and financial improvements occurring with each passing quarter since H2 FY22 and FY23, industry players have resumed work on previously stalled projects, delayed due to the pandemic.

Chart 1: Room Inventory



Source: Hotelivate, CareEdge Ratings

India currently has approximately 166,000 branded hotel rooms/keys. The industry is expected to add a capacity of approximately 55,000 rooms in the next 5 years with supply registering a CAGR of 4.5-5.5% in the said period. Year 2022-2023 had reasonable supply growth, which mainly consisted of projects in advanced completion which were delayed or stalled due to Covid and FY24 players started with new projects and capacity additions was higher than earlier two fiscals but lower than pre-covid level of FY20.

The growth of chain-affiliated supply is occurring through conversions that are being signed and implemented over a shorter period. Few existing hotels may be transacted as hotels with possibly a change of positioning or brand, these could be the ones which were closed during pandemic.

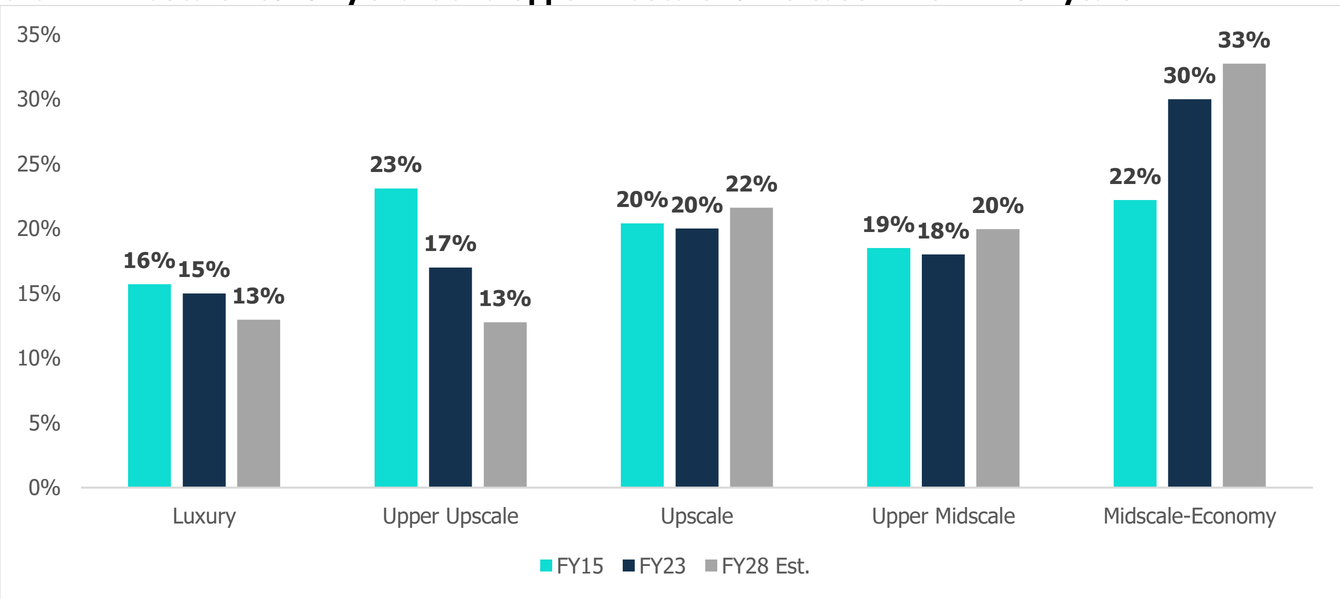
With new supply additions, the occupancy levels in the industry are expected to hover between 67-69% in the next two financial years of 2025 and 2026 and ARR are expected to stay strong. Since growth in supply is lagging demand, which is expected to be in high single digit or early double digit, this will support RevPAR of players which is expected to grow by 8-9% in FY25 to Rs. 5,200-5,400 and thereafter 5-6% in FY26 on a high base for all India average.

Segment-mix tilting towards Upper Midscale and Midscale Economy segments

Presently, supply is more balanced across different segments, as compared to an earlier mix that was heavily weighted towards luxury and upper upscale hotels. Over the years the supply concentration in the luxury-upper upscale segment has reduced from 39% in FY15 to 32% in FY23 and is expected to reduce further to 26% by FY28 as majority new supply is coming in Upscale, Upper midscale and Midscale/Economy sections. This reduction in supply share is in spite of new rooms being added in all the segment; better balance has arisen due to material supply growth by rooms in upscale, upper midscale and midscale-economy segments.

Several global/Indian hotel operators have also launched sub-brands with the clear focus on quality within key destinations which not just helps them in swiftly building a pool of quality inventory with presence in across segment but also aids better allocation of their capital. While traditionally, hotel owning companies in India grew predominantly via greenfield developments. The industry dynamics witnessed a significant shift from investing to exploring the multiple asset light options such as management contracts, franchising or revenue sharing models. These models help in increasing the revenue and EBITDA margins for major players without major capital expenditure. With creation of a robust demand base, the upcoming supply pipeline currently shows a clear correlation vis-à-vis the upcoming tourism and infrastructure developments that are taking place in Indian landscape.

Chart 2: Midscale Economy share and Upper Midscale to increase in next 2 to 4 years



Source: Hotelivate, CareEdge Ratings

Focus on Virgin markets in Tier 2 & 3 cities

Traditionally, the focus of the hospitality industry has been on Tier 1 markets due to the sizeable demand footprint and minimal seasonality in these locations which makes for a healthy occupancy rate. However, with the rising domestic tourism post covid era, new markets are emerging majorly in Tier 2 & Tier 3 destinations and major supply is being planned in these new locations and not alone the gateway cities of India.

In absolute terms, Bengaluru has the highest inventory of more than 18,600 rooms and New Delhi and Mumbai continues to be the second and third largest market in terms of absolute inventory. In recent years, several Indian destinations have emerged as significant growth frontiers either due to their popularity as leisure destinations or for faith tourism. Riding on the growing domestic tourism, the new supply is largely centred centered in Tier 2 & 3 with more than 70% of the proposed supply followed by Tier 1 on account of owners and operators exploring opportunities to capture unaccommodated demand in emerging and virgin markets.

CareEdge Ratings View

"On the back of the surge in domestic consumption and underlying GDP growth, the players in the industry are witnessing strong capacity utilization. With sharp increase in capacity utilization combined with stable supply growth, hotels are seeing significant ability to yield the demand for branded hotels on an ongoing basis which shall support the strong ARR at current levels or drive some growth as well in the medium term. While material contribution from international travellers is yet to materialize, currently the domestic demand is the key driver. With the current travel momentum to continue and anticipated demand likely to outpace current supply over the medium term and FY25 is likely to witness higher RevPAR's which shall aid in overall improvement of credit profile of the players in the industry," said Ravleen Sethi, Director CareEdge Ratings.

CareEdge Ratings expects industry to report average RevPAR growth of 8-9% in FY25 to Rs. 5,200-5,400 on a high base of FY24 and followed by a 5-6% rise even in FY26.

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