Hotel Occupancy in FY23 Set to Cross Pre-Covid Levels at 67-69%

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Synopsis

One of the biggest victims of the pandemic, the hospitality sector is seeing a reversal in its fortunes. Not only did it make a steady recovery in FY22, but H1 FY23 was also a record-breaking summer for the sector. With the sector entering its seasonally stronger second half, the demand rebound which was sharper than envisaged is expected to hold. The same will be aided by strong demand from the wedding segment and visible traction in corporate as well as a surge in Meetings, Incentives, Conferences and Exhibitions (MICE), direct segments and pick up in foreign inbound travel.

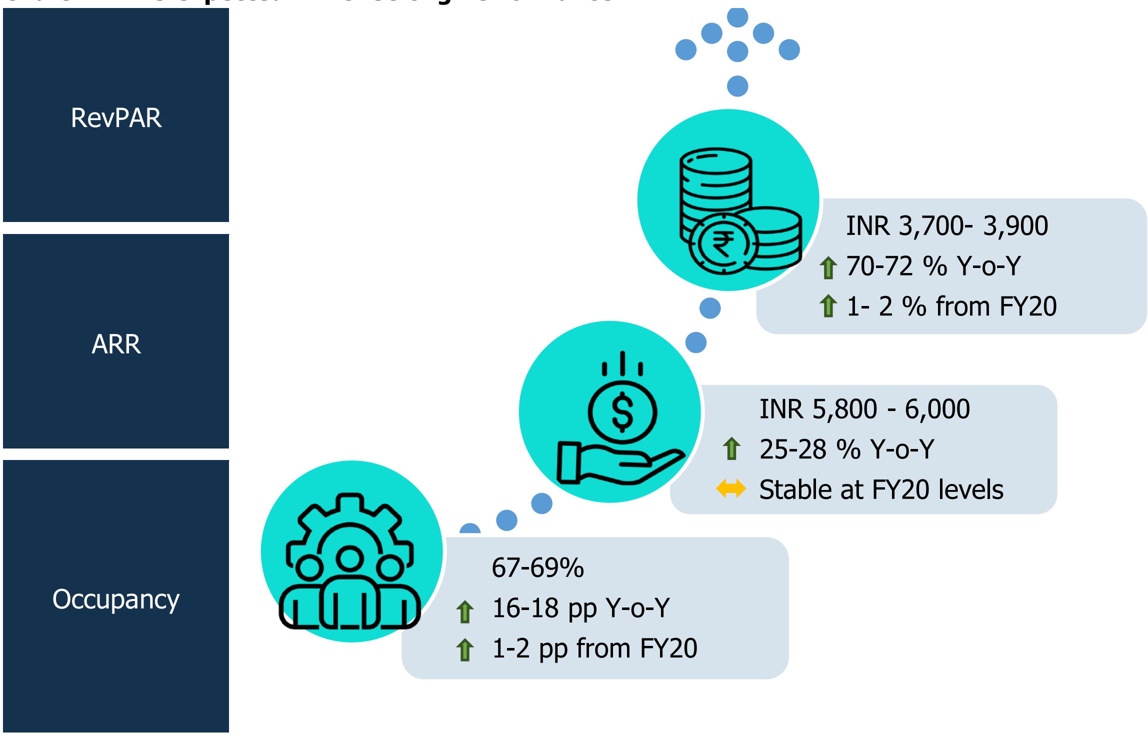
- Pan-India average occupancy for H1FY23 is expected to be in the 63-65% range, 22-25 percentage points (pp) higher than H1FY22, and almost inching back to the pre-pandemic levels. The strong recovery in demand is driving steady increases in Average Room Rates (ARR), with hotels, particularly in the leisure sector, surpassing their pre-pandemic ARRs along with corporate travel and MICE gaining momentum.
- As the first half of FY23 boomed with travel demand, the ARR's in H1FY23 are expected to average out 45-49% higher than H1FY22. Capacity addition in the industry got slowed during Covid, hence inventory is going to be limited which is giving cushion to the pricing.
- The strong recovery in occupancy and average rates shall cushion the sector's Revenue per available room (RevPAR) to reach Rs 3,500-3,700 in H1FY23, which should reflect growth of over 130% compared to H1FY22 and almost in line with pre-pandemic levels in H1FY20.
- Domestic demand reported a strong recovery while international travel is still lagging. With pick-up in foreign inbound travellers in H2 coupled with resilient domestic demand, H2FY23 is expected to be stronger.
- For FY23, pan-India average hotel occupancy is expected to be at 67-69% which shall surpass the pre-covid levels and ARR at Rs 5,800-6,000, thus leading to margin expansion for the players.

Industry Occupancy and RevPAR's Heading North

As per industry data available, ARR has been able to sustain over the pre-pandemic levels in Q1FY23. In Q2FY23, the industry ARRs were 7-9% higher than Q2FY20 levels at Rs 5,750- 5,850. The overall average occupancy is expected to decline by approximately 300 bps in Q2FY23 to 62% vs. 65% in Q1FY23. Hence, Industry is expected to report RevPARs of Rs 3,500- 3,600 in Q2FY23 leading to 6% decline Q-o-Q due to the second quarter being a lean or weaker quarter from a season perspective along with pent-up demand and events like the IPL driving up RevPARs in Q1FY23. The average occupancy in Q2FY23 is still at par with pre-pandemic levels when compared to a similar period.

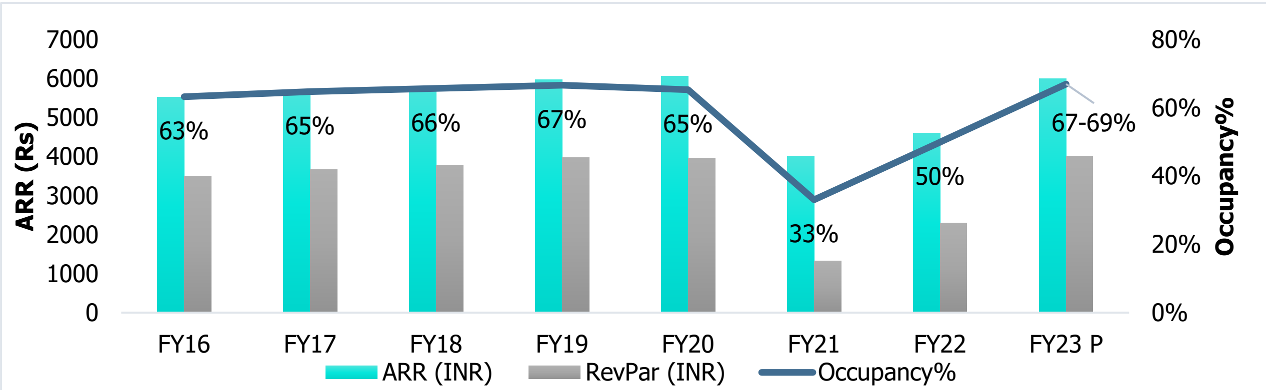
As demand aligns with the pre-pandemic levels, H2FY23 looks promising. Factors such as festivities and wedding season and a likely pickup in foreign inbound travel and MICE activity will also support demand. Soaring international airfares and longer waiting times for travel approvals/visa amid rising inflation may limit outbound travel from India, and thereby enhance domestic demand in the medium term.

Chart 1: FY23 expected KPI's: Strong Performance



Source: CareEdge, HVS Anarock, Industry data.
KPI: Key performance indicators, pp: percentage points, ARR: Average room rate, RevPAR: Revenue per available room

Chart 2: Occupancy on the Rise



Source: CareEdge, HVS Anarock, Industry data.

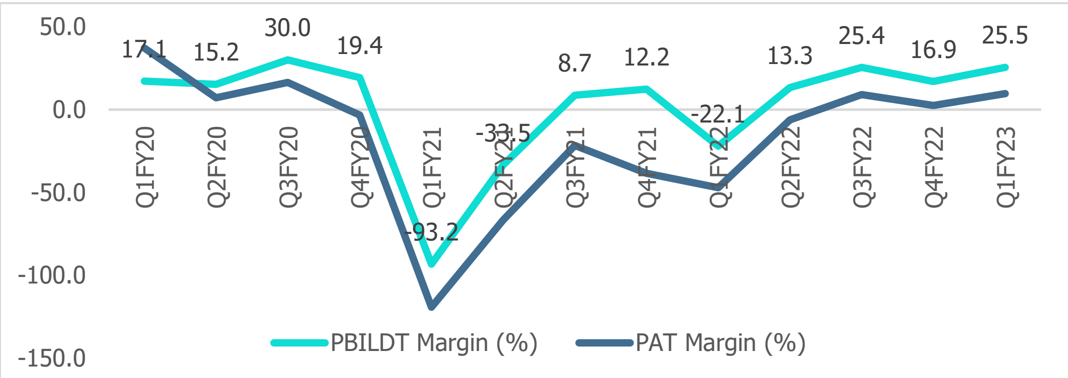
Though inbound foreign travel has increased in the recent past, it is still far from the pre-Covid levels. Pent-up demand and a weak Indian rupee, however, is likely to provide a fillip to the segment in H2FY23. Considering the narrowing gap between supply and demand, occupancies are expected to witness improvement, thereby leading to better pricing power with the players. For FY23, pan-India average hotel occupancy is expected to be at 67-69% which shall surpass the pre-Covid levels and ARR at Rs 5,800-6,000.

Given the buoyant demand, CareEdge has revised its expectations up from the last estimated occupancy of 65-66% and ARR of Rs 5,400-5,500 in June 2022. All the players are likely to record pre-Covid levels of revenue in H1FY23 with some to even surpass the same.

Operating Margins to Grow in FY23

Sustenance in fixed cost-saving initiatives undertaken by all the players in the industry in the last two years and better operating leverage will be the building blocks to help them register growth in operating margins in FY23. With the rise in occupancies, costs for all the players have though inched up, the same remains still remains lower than the pre-covid levels aiding margin growth for the industry. As revenues improved in the past few quarters amidst the realignment of the cost structure done by players, the industry has been able to post profits at the operating level since Q2FY22. With industry's focus intact on tight cost control measures, players are expected to record margin expansion in FY23. The industry registered its best-ever operating profit in Q1FY23 and profitability remained strong at the net level as well. The sample set of players as taken for analysis in Chart 3 have reported 25.5% profitability at the operating level in Q1FY23 as against losses of 23% in the year-ago quarter.

Chart 3: Quarterly Profitability Trend from Pre-Covid to Post Covid



Source: CMIE, CareEdge (sample set of listed players)

CareEdge View

Maintaining a stable outlook for its rated entities, CareEdge expects the hospitality sector to report a stronger second half in FY23. For the full fiscal, we expect most of our portfolio to perform nearly around pre-Covid levels. This growth would primarily be driven by domestic tourism, corporate activities and inbound international travel.

The strong rebound in occupancies and sustenance of higher ARRs shall lead to growth in the sector's revenue profile and drive the sector's profitability up by 200-250 bps in FY23. The debt-to-equity ratio though shall improve on a year-on-year basis but continue to be weak for the sector (over 1x) as companies have resorted to additional debt in the last two years to support their operations and incurred losses that have a bearing on the net-worth position.

"With a sustained recovery in operating leverage, the sector is expected to report healthy operating margins thereby leading to improved coverage and leverage indicators for the players compared to the past two years. The sector may witness some impact of the headwinds on account of rising inflation, higher labour and borrowing costs due to rising interest rates which will weigh on the profitability for the sector in H2FY23, nevertheless with the strong demand and the average room rates for the sector inching to the north of pre-Covid levels, the credit profile for players is expected to improve," said Ravleen Sethi, Associate Director – Corporate Ratings.

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