Hospitality industry: Survival before revival

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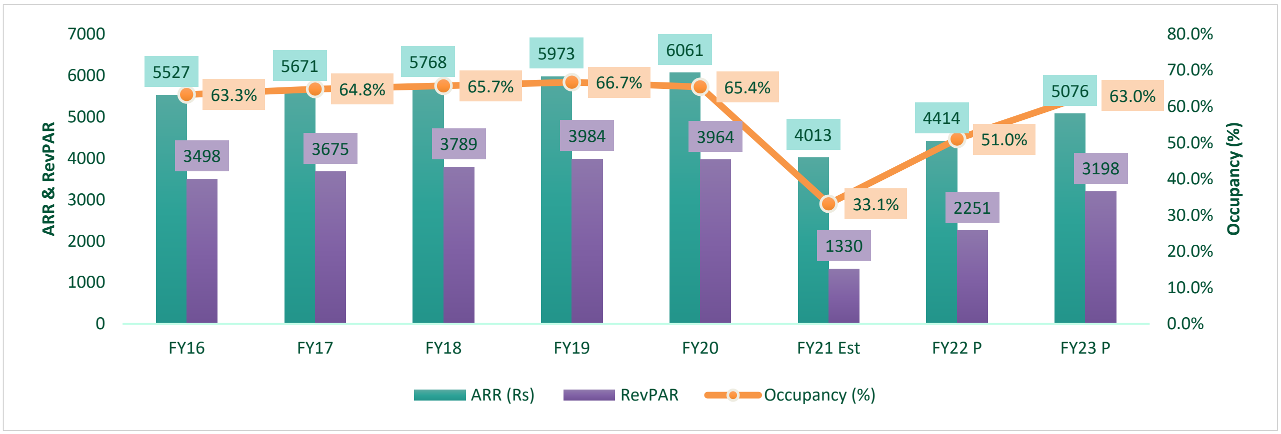
The second wave of Covid snapped the momentum gained in the second half of FY21 for the hospitality industry. The path to recovery, that the industry was slowly but steadily treading, has been derailed now. The hospitality industry is expected to report losses in FY22 as well although the same shall be lower compared with the operating loss witnessed in FY21. Sustained cost-saving initiatives of fixed costs undertaken by the players in FY21, and better operating leverage will be the supportive factors. With the rise in occupancies, costs in FY22 are expected to inch-up marginally, however, it would still be lower than the pre-covid levels. CARE Ratings expects the industry to pick up gradual pace from October 2021 onwards, though, revival may be gradual over 18 months to hit the pre-covid level occupancies and average room rates (ARRs); with likely resumption of international travel and corporate business. ARR is likely to witness a 7%-10% uptick y-o-y but expected to be 30%-35% down from pre-covid levels. ARR normalcy may only be achieved post recovery in occupancies. Recovery for some select players may be faster owing to strong brand recall and scale, leveraged balance sheets, though remains an overhang on profitability. Due to the pandemic, the industry players have undertaken realignment of the cost structures, which in CARE Ratings' view has formed a strong base for future profitability.

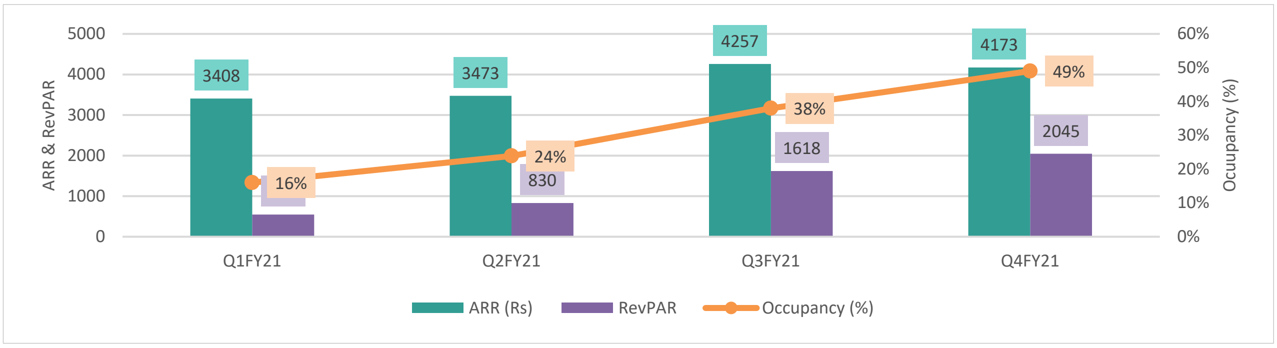
Sharp decline in occupancy, ARR and RevPAR in FY21

The global crisis pushed the sector to historically low occupancies in FY21. The strong linkage that the hospitality industry has with travel and tourism, and the void that the foreign travel and tourism created is evident in the fact that the occupancy plunged to 33% in FY21 from over 65% earlier. ARRs dropped by 35% in FY21. The occupancies are unlikely to increase beyond 50%-55% in FY22 given the impact of the second wave and the fear of the third wave of the pandemic.

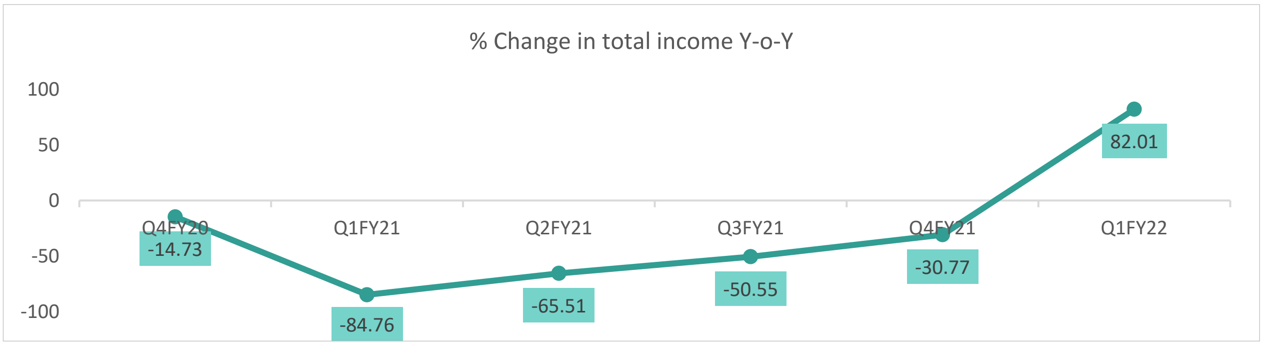


Source: Hotelviate, CARE Ratings

Commencing from October last year, some respite was witnessed, and the occupancy levels started to exhibit signs of recovery, however, it remained sub-50% as of the last quarter of FY21. The ARRs also improved quarter-on-quarter. The recovery, while slow, has been visible quarter-on-quarter; however, due to the pandemic and lock-down for major part of FY21, the industry made losses in each of the quarters of the year.



Source: Hotelviate, CARE Ratings



Source: CMIE, CARE Ratings (sample set of 52 companies)

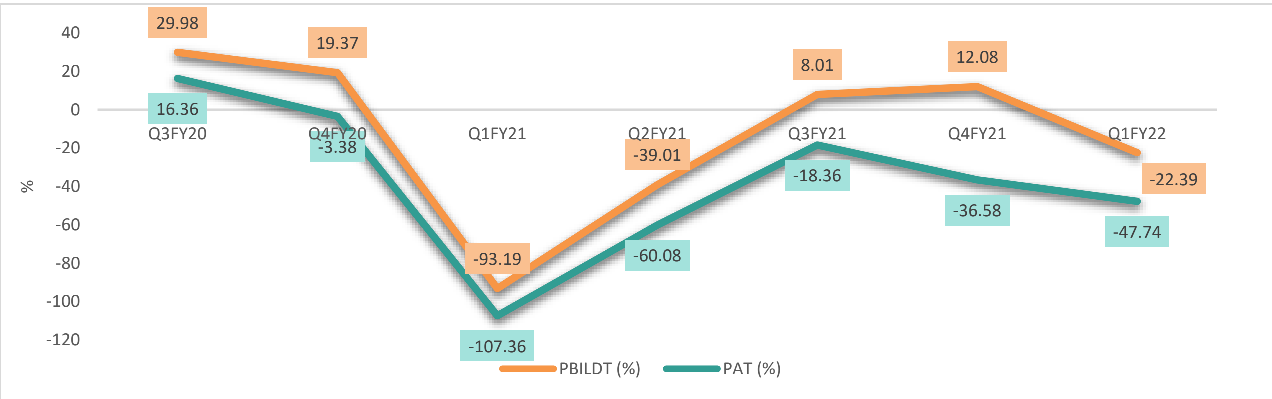
The hotel industry's revenues in Q1FY21 dropped by approximately 85% compared with the Q1FY20. Partial and regional lockdowns led to revenues declining by approximately 65% year-on-year in the Q2FY21. The suspension of international flights which continued even after June 2020 hit the industry's revenues from foreign tourist arrivals along with the revenue from in-flight catering services. Even Q3FY21 did not witness any major recovery, and the revenues were lower by around 50% in that quarter. Revenues of the industry tanked by approximately 31% in the Q4FY21 after plunging by over 50% in each of the earlier quarters. With the bleak scenario, the hotel companies resorted to alternative customer segments and ancillary streams of revenue to survive these tough times such as offering isolation and quarantine centres along with long-stay and meal programmes to generate additional revenues; however, these streams were neither significant enough to make a sizeable impact nor sustainable in the long run.

Second wave: Survival mode continues

The March 2021 quarter witnessed fruition of the expected pent-up demand and provided only a glimmer of hope with occupancies and ARR recovering but the second covid wave dashed expectations of any decent recovery anytime soon. With the surge in cases and the ensuing state-specific restrictions, the already crumbling sector has once again lost the momentum it had gained.

The demand for leisure destinations that was a key driver for recovery in revenues in H2FY21 was affected. Q1FY22 was better than Q1FY21, in terms of operational and financial performance of majority of the players due to a low base of Q1FY21. The industry reported an 82% y-o-y growth in its sales revenues Q1FY22. The losses at operating level, however, continued even in Q1FY22.

CARE Ratings, however, believes that post this temporary brake on the journey towards revival, the industry shall gradually pick-up and factors such as progression of the vaccination drive coupled with pent-up travel demand for past few quarters are likely to auger well in the medium term. Tourist arrivals, foreign and domestic, particularly leisure travel, are still unlikely to witness recovery to pre-covid levels before the end of the current financial year and even by the end of the first half of the next year. Besides looking at alternative customer segments and revenue streams, albeit weak, the industry's focus has shifted to controlling and reducing costs significantly which include redeployment of manpower, downward salary revisions, re-negotiating terms with utility service providers including internet, telecom, laundry, limiting buffet menus, centralization, and automation of business functions. Sustenance in fixed cost-saving initiatives undertaken by all the players in the industry in FY21 and better operating leverage will be the supportive factors in FY22 as well. With the rise in occupancies, costs in FY22 are expected to inch-up marginally, however, it would still be lower than the pre-covid levels. As revenues dropped for five consecutive quarters, the industry reduced operating costs albeit by a lesser margin. The industry has therefore suffered net losses for five consecutive quarters including Q1FY22.



Source: CMIE, CARE Ratings (sample set of 52 companies)

Outlook on revival:

However, not all is lost for the sector, as travels and tourism witnessed an uptick post relaxation of the lockdowns since June 2021 and decline in covid-19 infection figures. Post May 2021, the travel aggregators have reported a sudden surge in bookings, both for the 'staycation' and 'workcation' segments. Positive market sentiment also stems from vaccination of a large of part of population including the hotel staff for the larger hotel chains. The leisure locations are particularly attracting attention. While international travel demand is expected to remain muted in the next 2-3 quarters largely due to continuing restrictions, the domestic tourism is expected to be the growth driver in the near-to-medium term. The bookings for the peak season of October-December are usually made in advance during summers by international tourists, however, not much traction has been observed yet for the upcoming season on account of the prevailing uncertainties. The restrictions on international travel could be a silver lining in as much as some proportion of these tourists instead opting for domestic travel. It is noteworthy to mention that around 25 million tourists from India travel to international locations annually. Due to the pandemic, large pie in this population of tourists is expected to stay in the country and explore domestic destinations.

Furthermore, among the leisure and business segments, the leisure segment is likely to revive earlier than the business segment. During the past two lockdowns, several corporates have successfully tested and implemented the alternative work-from-home model of operating both for internal as well as external interactions. The minimal cost and added convenience associated with the model could imply that a significant portion of companies might persist with holding webinars and online conferences, instead of conferences requiring collective travel and stay at hotels, even after the crisis tides over. The corporate and meetings, incentives, conferences, and exhibitions (MICE) segment is unlikely to pick up before FY23. While some green shoots are visible, the road to recovery is still quite long and pick-up in momentum is not expected before Q3FY22. That said, the occupancies may take at least 6-8 quarters to return to pre-covid levels. Further, brownfield expansions within the industry shall be pushed ahead by few quarters as well, owing to the already under-utilized inventory.

Key drivers for FY22:

Positives:

- Pent-up travel demand is likely to provide boost to the sector
- Cost containment measures adopted to tame operational losses by hoteliers
- Acceleration in the pace of the ongoing vaccination drive with timely inoculation of hotel staff shall lead to enhanced confidence among travelers
- Ability to deleverage balance sheets through equity fund-raise activities

Negatives:

- Slow pick up demand considering prospective next covid wave
- Underutilization of existing inventory and deferment in capacity expansions in near future
- Increased cost outlay to hoteliers on account of customer preference towards hygiene and safety precautions
- High interest cost burden on account of huge debt pile-up on balance sheets, specifically, for companies with portfolio of ramping-up assets.

For FY22, CARE Ratings estimates the majority of its portfolio of hotel companies to report sluggish performance although there will be an improvement from the low base of FY21. The domestic tourism is expected to be the growth driver in the near-to-medium term. Positive market sentiment also stems from vaccination of a large of part of population including the hotel staff for the larger hotel chains. The situation is, however, still evolving and the same remains contingent not only on the pace of vaccination and efficacy of the vaccines but also on the possibility of a third Covid wave and its severity on the sector. The profitability margins are expected to be severely hit during FY22 owing to operational losses reported in initial part of the year. For the remaining year, cost optimization and its sustainability shall be the key to survival. In terms of debt, significant debt pile-up leading to overburdening of balance sheets and increased interest cost in near-to-medium term is envisaged. As seen in the past, most of the companies within the sector have availed debt under ECLGS 1.0 and 2.0 and through other long-term debt to restore their liquidity for meeting operational losses and debt obligations. Few players, backed by resourceful investors/ promoters have also resorted to equity fund raise. Liquidity for majority of the players is likely to remain stretched for FY22 characterized by lower cash accrual generation, fully utilized working capital lines, and low cash balances. The repayment obligations shall also peak in the near-to-medium term, necessitating equity raise or resorting to debt refinancing.

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