Hotel industry: long way to recovery

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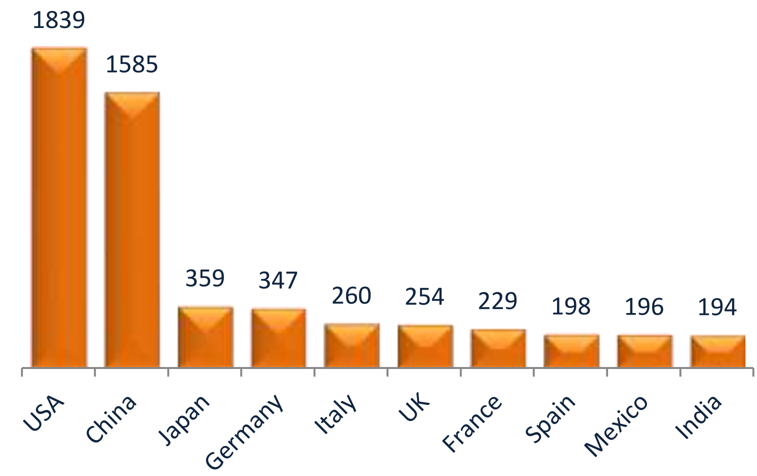
The Indian hotel industry is among the sectors that have been impacted the earliest by the outbreak of the Covid-19 pandemic on account of its inextricable linkage with travel and tourism, especially foreign travel and tourism, which evidently bore the first brunt of the global crisis. Likewise, it may be among the last sectors to recover, considering that due to its nature, travel and tourism is a discretionary activity. Additionally, with corporate entities all over the world getting acclimatised to interacting internally or externally in a zero-cost work-from-home mode, the resumption of business traffic, even in the event of the pandemic abating, is expected to be tardy.

Sector was on an uptrend till 2019

The Indian hospitality industry along with tourism has been one of the key segments driving the growth of the services sector in the Indian economy. According to the World Travel & Tourism Council (WTTC), the Indian travel and tourism sector contributed about US$ 194 billion during CY2019 contributing around 6.8% of the country's GDP. Out of the 185 economies, India stood 10th in terms of the size of travel and tourism spends during 2019.

Chart 1: 2019 Travel & Tourism contribution to GDP (in US$ billion)



Source: World Travel & Tourism Council

As per WTTC, during CY2019, the domestic spend stood at 83%, while international spend stood at 17%. Out of the total travel & tourism GDP for CY2019, 94% was towards leisure spend, while only 6% was towards business spend. The global average for domestic spend to international spend stood at around 71:29, while leisure spend to business spend stood at 79:21. The sector also has an economic significance in terms of employment generation – the contribution of travel and tourism to

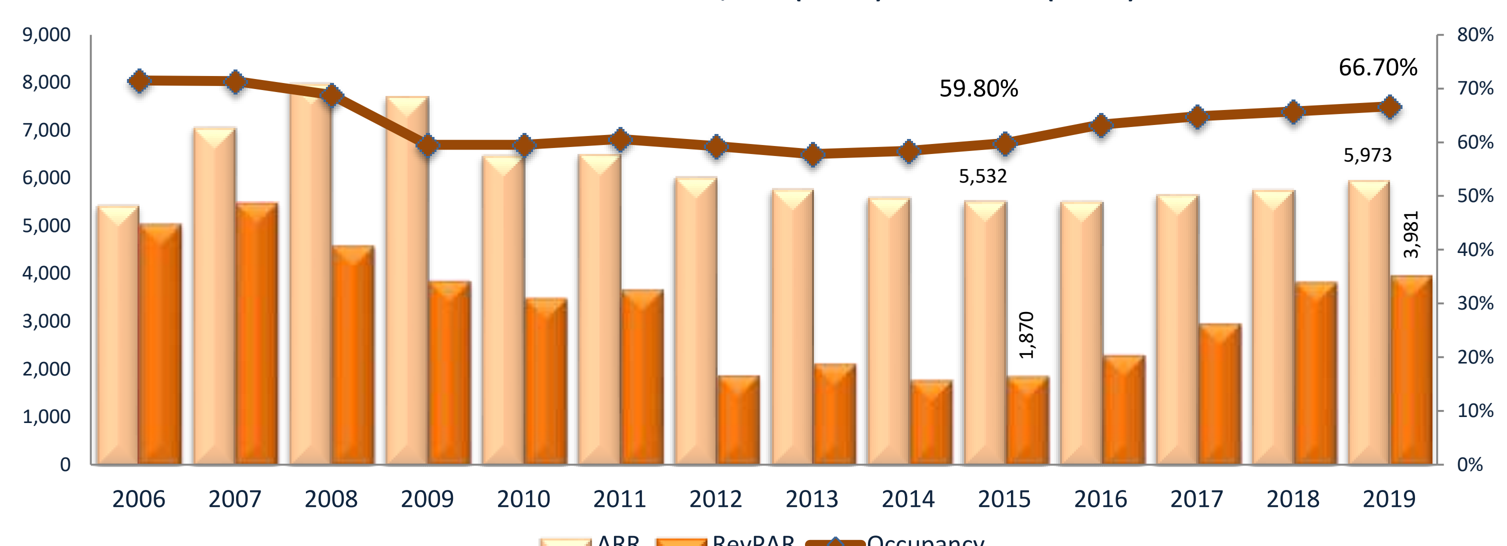
domestic employment stood at around 40 million jobs during 2019, representing around 8% of the total domestic jobs.

As seen in Chart 2, the Indian hotel industry was treading on an up-cycle over the past five years, demonstrating a persistent improvement in its operational performance metrics. Consistent growth in demand was backed by a prospering domestic economy, higher disposable income, and increasing foreign tourist arrivals (FTAs).

During 2019, FTAs in India stood at 10.89 million, achieving a growth rate of 3.20% y-o-y. FTA has demonstrated continuous growth over the last decade and the number has almost doubled from 5.4 million during 2010 to 10.89 million during 2019. Furthermore, during 2019, Foreign Exchange Earnings (FEE) from tourism increased by 4.8% y-o-y to Rs.1,94,881 crore (US$ 29.96 billion). In 2019, arrivals through e-Tourist Visa increased by 23.6% y-o-y to 2.9 million.

The occupancy rate (OR) increased from 59.8% during 2015 to 66.7% during 2019. On the supply side, the rate of addition to room inventory, on the whole, was moderate over the period. Consequently, the average room rate (ARR) increased from Rs.5,532 to Rs.5,973, thereby registering a growth of around 8%. Given the increasing trend in occupancy rate and ARR, revenue per available room (RevPAR) increased from Rs.1,870 to Rs.3,981 registering a growth of over 200% during the same period.

Chart 2: Trend in Overall OR%, ARR (in INR) and RevPAR (in INR)



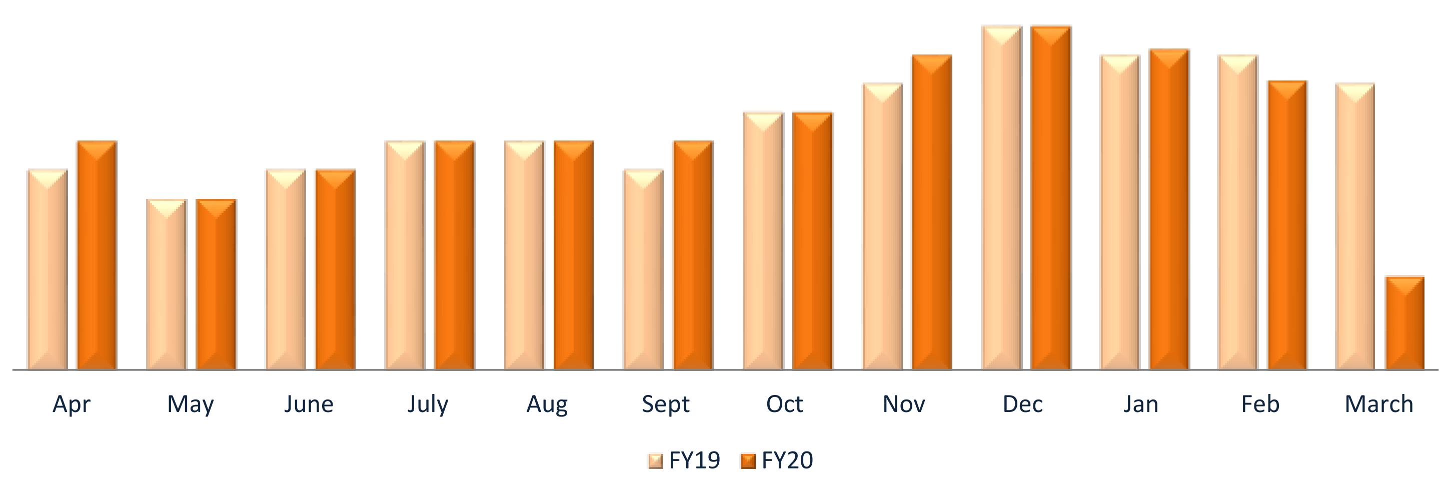
Source: Hotelivate, CARE Ratings

Pandemic and lockdown had a severe impact on revenue: a sharp decline in occupancy, ARR and RevPAR

The outbreak of COVID-19 severely impacted the occupancy level of hotels across all the segments. While the early signs of demand destruction in the domestic hotel industry started to seep in from February 2020, it only worsened by March.

FTAs witnessed a y-o-y de-growth of 6.6% during February 2020 indicating the first adverse signs of the pandemic. By March 2020, the pandemic had spread across various nations, and from March 02, 2020, the Government of India (GoI) also started issuing travel restrictions in a phased manner. As a result, FTAs witnessed a significant year-on-year (y-o-y) de-growth of 66.4% during March 2020.

Chart 3: FTA in Millions



Source: Ministry of Tourism

The outbreak of Covid-19 in the country was closely followed by a nation-wide lockdown to contain the pandemic. The lockdown was implemented on March 24, 2020, which continued till May 31, 2020, under four phases, leading to a significant deterioration in the operating parameters of hotels. CARE believes that the average occupancy levels have plummeted to a range of 10%-15% during April and May 2020 for domestic hotels. Hotels have been able to generate minimal occupancy by deploying their rooms for quarantine patients, stay of medical staff, and employees of some corporate at nominal rates. Consequently, ARR and RevPAR have also been severely impacted. Apart from the room revenue, the hotel players are also expected to lose significantly on the food & beverages (F&B) portion which typically contributes around 35%-40% of the total revenue.

Chart 4: Operational Performance April & May 2020

	April 2020	Y-o-Y Change %	May 2020	Y-o-Y Change %
Occupancy Rate %	11.7%	-82%	14.3%	-78%
Average Room Rate	Rs. 4,113	-27%	Rs. 3,353	-37%
Revenue Per Available Room	Rs. 482	-87%	Rs. 481	-85%

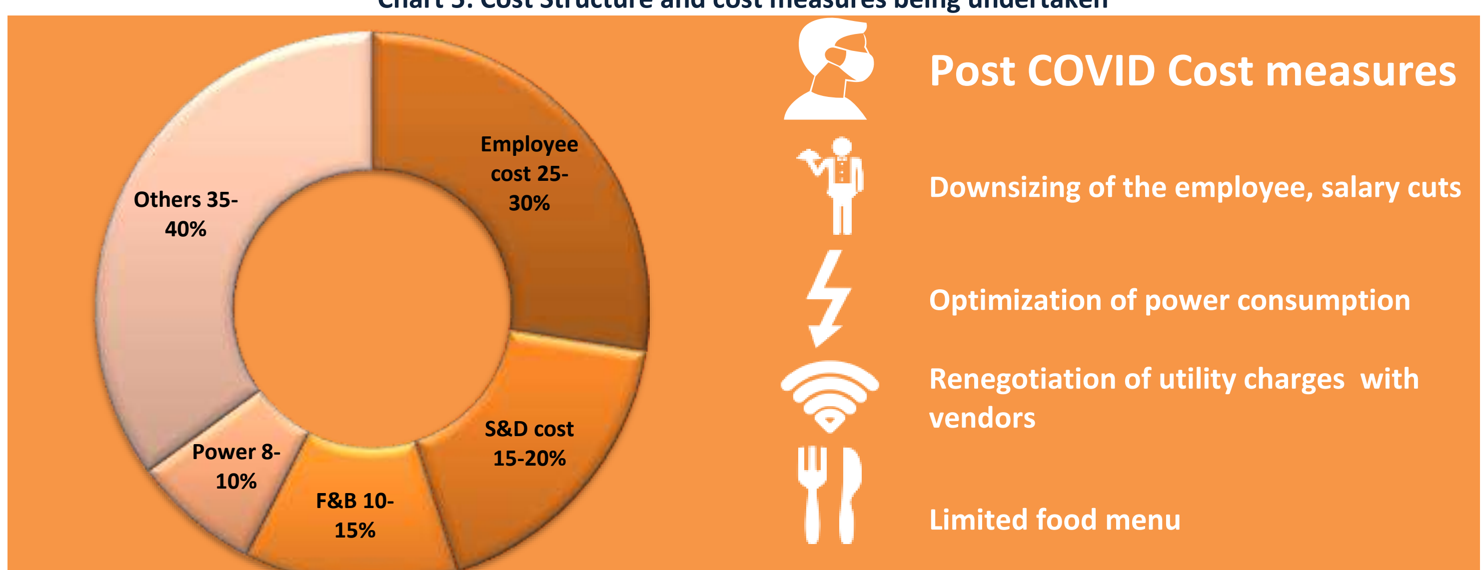
Source: HVS, CARE Ratings

Profitability expected to get squeezed

The domestic hotel industry has never been impacted as adversely as during the ongoing COVID-19 crisis. Besides struggling with plunging revenues, hotels have been grappling with shrinking profitability, primarily on account of a high share of fixed costs, and consequently high operating leverage.

According to CARE Research, employee costs are one of the largest cost components of Indian hotels, accounting for around 25%-30% of the total expenditure. Besides, selling & distribution (S&D) costs account for about 15%-20% of the operating costs which include advertising expenses and marketing costs, and power & fuel costs account for 8%-10%. Hotels, therefore, have large fixed costs, and marginal costs per additional guest are comparatively low. Besides, F&B consumes about 10%-15% of the costs on an average. Other operating costs account for the remaining 35%-40% of the costs that include the repairs and maintenance, travelling expenses, etc., among others.

Chart 5: Cost Structure and cost measures being undertaken



Source: CARE Ratings

We understand that hotel entities have realigned themselves to some extent post breakout of COVID and have also trimmed down cost by implementing cost rationalization and efficiency improvement measures. Hotels have worked towards cutting down on the employee cost which is the largest cost component for them. Hotels have reportedly resorted to downsizing of the employee pool and also revised the salaries downwards.

Furthermore, in terms of cost rationalizations, hotels are re-negotiating terms with utility service providers such as internet, telecom, laundry, etc, and have started taking measures such as shutting down certain floors in orders to save on power consumptions and limiting their buffet menu. Hotel entities are taking these cost-cutting measures to manage their cash flows and liquidity. These measures would certainly help the hotel entities to witness improvement in their profitability in the coming quarters once the demand starts picking up; the majority of them are expected to report a loss or minimal profits during Q1FY21.

Expectations on recovery

While the GoI has provided guidelines to hotels for resuming operations (other than those located in the containment zones) from June 08, 2020, CARE Ratings believes the recovery for the sector is still 2-3 quarters away.

International vs Domestic: CARE Ratings believes the FTA is not expected to improve before Q1FY22 as travel bans across the globe are likely to lift only in a phased manner. Notwithstanding the timing of the lifting of such bans or advisories, the discretionary nature of foreign tourist travel is expected to queer the pitch further. The booking for the peak season of October-December is made in summers by international tourists, and not much of traction has been seen yet for the upcoming season on account of the prevailing uncertainties. The only green shoots are expected in the domestic tourism segment, which is expected to recover faster as compared to the foreign tourism segment. The ban on international flights could have a silver lining in as much as some portion of domestic tourists wishing to travel abroad could opt for travelling in India. It is noteworthy to mention that around 25 million tourists from India travel to international locations annually. Due to the pandemic, this huge population of tourists is expected to stay in the country and explore domestic destinations.

Business vs Leisure: CARE Ratings believes that among the two segments, the leisure segment is likely to revive earlier than the business segment. During the lockdown, several corporates have successfully tested and implemented the alternative work-from-home mode of operating both for internal as well as external interactions. The minimal cost and added convenience associated with the mode could imply that a significant portion of companies might persist with holding webinars and online conferences, instead of conferences requiring collective travel to and stay at hotels, even after the crisis tides over.

Upscale vs mid-market: The impact of the pandemic has been most on the upscale segment – driven significantly by FTA – since the FTA movement has completely dried up and is not expected to revive any soon. It is the mid-market hotels that are expected to be the preferred choice of domestic tourists and given the fact that the majority of tourism will be domestic in the coming quarters, CARE Ratings believes mid-market hotels to witness a quicker revival than the upscale hotels.

Even if the travel bans are lifted, the fear of getting infected is likely to deter tourists from planning travel for some time. Nevertheless, CARE Ratings expects that the performance should gradually pick up from Q3FY21 onwards and should reach a moderately comfortable position by Q1FY22. The revival in the industry is likely to be led primarily by domestic tourists travelling for leisure purposes and opting for mid-market hotels.

Table 1: Occupancy rate (%) expectations for FY21

	Q1	Q2	Q3	Q4	Full year FY21
Optimistic	15	25	40	50	33
Base	15	20	25	35	24
Pessimistic	10	15	20	25	18

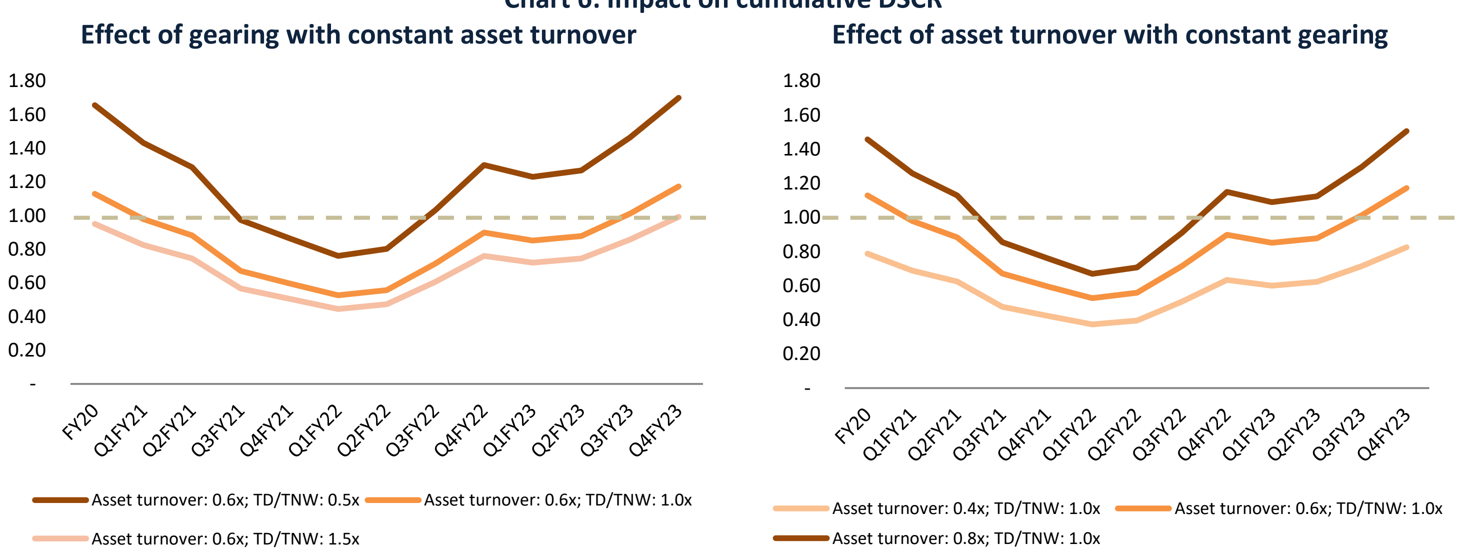
According to CARE Ratings' base case, the occupancy rates should start picking up from Q3FY21 and end the year at around 35% with a full-year average of around 25%. In a pessimistic case where the impact of the pandemic is deeper, the expected occupancy rates would be lower ending at around 25% by Q4FY21. In an optimistic scenario, wherein the spread of pandemic is curtailed earlier, CARE Ratings expects the industry to witness an occupancy rate of around 50% by Q4 with a full-year average of around 35%. Nonetheless, the recovery is expected to be protracted for all the demand segments, and recouping the pre-COVID level occupancy rates might take six to eight quarters.

Credit Perspective

For the majority of CARE-rated entities in the hotel sector, their liquidity has been under stress on account of negligible or low business during Q1FY21. The companies have tried to reduce outflows by paring costs to the extent possible and renegotiating various service contracts as mentioned earlier. Realizations from debtors have also helped them pay off the fixed costs during Q1FY21. As per CARE Ratings estimates, companies have been able to trim down their fixed cost to the extent of 25% to 40%. Furthermore, majority of the players have availed of the moratorium facility extended by the RBI with respect to debt repayments. CARE Ratings believes these factors put together should enable them to stay afloat through two succeeding quarters.

However, the ability of hotel entities to withstand the crisis for any longer period would hinge upon the depth of their cash reserves, the robustness of their business models, and continued support from promoters. A key determinant of their resilience under persisting stress situations would be their vintage and their business model, as reflected in their asset turnover. Asset-light companies or those with depreciated operating assets would be expected to emerge from the crisis faster. Similarly, entities with lower gearing would stand to gain, since it would be easier for them to firm up their solvency in the event of revival in occupancy rates.

Chart 6: Impact on cumulative DSCR



Assumption: Scenarios run on a hypothetical 100-room hotel property

The impact of asset turnover and total debt/total net worth on cumulative debt service coverage ratio (cumulative DSCR) may be seen in Chart 6. Entities with lower asset turnover and higher leverage – or inadequate equity support during these times – could see a more protracted recovery, stretching beyond FY22. Several companies are already availing of additional debt to fund their working capital requirements, residual capex, or manage any cash flow mismatches to be ready for future exigencies. Notably, hotel projects are characterized by a long gestation period; consequently, a majority of the hotel entities are already leveraged, and further leveraging would only add to their woes. Hotel companies with recent expansions or groups with a higher portfolio of new assets compared to mature assets are expected to face additional stress on their already weak financials. With high debt repayments and squeezed profitability, such entities will witness considerable deterioration in their credit profile and would remain under considerable stress during the current financial year.

CARE Ratings believes that the subsequent 2-3 quarters are going to be a defining period for the participants in the hospitality sector. If green shoots do not emerge by Q1FY2022, asset-heavy and leveraged entities might find it difficult to sustain themselves. On the other hand, experienced players with strong and resourceful parentage or asset-light companies with low leverage would be better positioned to tide over the crisis.

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