Hotels to See 9-11% Revenue Growth in FY25, Third Straight Year of Growth in Current Upcycle

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CareEdge RATINGS

Synopsis

- The robust resurgence in demand, coupled with the gradual alignment of supply and demand of branded hotels room inventory, has been a noteworthy facet of the hospitality sector's post-pandemic trajectory. The sector is currently in the second year of an upcycle. In FY23, RevPAR (Revenue per Available Room) recorded an impressive year-on-year growth of almost 88 per cent, reaching levels approximately 9 per cent higher than the pre-pandemic period, at Rs 4,200-4,400 (average for branded rooms in India). Pan-India, average room rates (ARRs) are expected to be around Rs 7,200 to Rs 7,400 in the current fiscal, which is likely to rise further to Rs 7,700 to Rs 7,900 in FY25.
- CareEdge Ratings estimate FY24 will end at RevPAR growth of 12-14 per cent on the high base of FY23. This growth momentum going forward is expected to be sustained in FY25, resulting in likely y-o-y revenue growth by 9-11% backed by healthy domestic leisure and business travel and complemented by increasing foreign tourist arrivals, contributing to an improved credit profile for industry players. The positive momentum in operating margins, which averaged 27-30% in FY23 (for a few key major players the margins are in the range of 33-35%) is also anticipated to persist over the next two years as the sector forges ahead.
- While supply of room inventory is expected to experience a delayed catch-up due to the protracted setup period for greenfield hotels, organized players are strategically expanding their footprint in an asset-light manner. Anticipated supply growth is estimated to range from 4% to 5% compounded annual growth rate over the next 4-5 years, adding over 50,000 rooms to the country's current inventory of approximately 160,000 branded rooms.
- Medium-term growth prospects are promising, bolstered by new tourism policies, increased budget allocations by GoI, and the government’s ambitious plans to expand and improve infrastructure through airports and road and highway development which is expected to bolster connectivity and thus aid travel and tourism.

Strong uptick in Key Performance Indicators

The robust resurgence in demand, and reduced supplies over the past couple of years, stemming from the pandemic-induced disruptions has led to occupancy rates registering a marked improvement, reaching an average of 67-68% in the current ongoing fiscal up from 65% in the fiscal year 2023 and a significant upswing from the 50% recorded in FY22. This uptick in occupancy has not only empowered industry players with enhanced pricing leverage but has also propelled an increase in average room rates.

Pan-India, ARRs on an average are expected to be around Rs 7,200 to Rs 7,400 in the current fiscal, which is likely to rise further to Rs 7,700 to Rs 7,900 in FY25. The hospitality sector's commendable recovery in occupancy rates and average rates has in turn cushioned its RevPAR, estimated to have climbed to an average range of Rs 4,800 to Rs 5,000 by the end of FY24 up from the 4,300-range registered in FY23 and is expected to grow by 9-11% in FY25 on the high base of FY24.

The culmination of these favorable factors has translated into a noticeable improvement in the industry's overall profitability during FY23. Among a sample set of 62 listed players (Source: CMIE) analyzed by CareEdge Ratings, the operating level profitability for FY23 was reported at an impressive 27.2% and it continues to be in similar range in the current fiscal as well. This represents a substantial leap from the 14.3% recorded in FY22 and the 19.3% reported in FY19 before the pandemic took its toll. Despite the inherent challenges posed by escalating costs of raw materials, high manpower expenses, and the upsurge in borrowing costs stemming from elevated interest rates, industry players have exhibited resilience. Demonstrating their adeptness in navigating these adversities, they managed to augment ARR. This achievement is projected to continue its upward trajectory, in tandem with the prevailing strong demand tailwinds. Consequently, it is envisaged that the RevPAR for industry players in FY24 will witness a 6-7% growth over FY23 levels.

Furthermore, the sector's transition into a growth phase in FY23 has been underscored by significant improvements across key financial parameters. While various key performance indicators have undoubtedly played their roles in buttressing the sector's robust operational profitability, equal credit must also be attributed to the sustenance of fixed cost-saving endeavors. These initiatives, which have been diligently pursued by all industry players over the last two years, have provided a foundational platform for realizing growth in operating margins during FY23. This positive momentum is anticipated to persist, thereby continuing to fortify the margins as the sector propels forward. Domestic travel will continue to be a significant driver of demand, bolstered by the government's infrastructure initiatives, increasing air and railway passenger traffic, and the rising preference for branded accommodations, which outpaces supply growth.

Capacity additions on the rise; Midscale- economy segment gaining share.

Furthermore, the resurgence in domestic tourism, especially leisure tourism, resumption of international flights, gradual recovery in foreign tourist arrivals (FTA's) and a gradual uptick in business travel demand on account of the rise in meetings, incentives, conferences & exhibition (MICE) events is expected to drive the increase in room capacity additions over the next few years.

Over the last five years, India's travel and tourism sector has contributed approximately 5% of total Gross Domestic Product (GDP) of India. India's tourism sector's contribution to the GDP is expected to grow to USD 450-500 bn by FY30. The rising urbanization in several tier-2 and tier-3 cities is also expected to drive the demand upward for hotels in different segments. Factoring this in, the industry is expected to witness a robust room addition over the next few years.

In FY21, capacity additions were at a year low as the hospitality industry practically came to a halt with the outbreak of Covid and suffered a huge fall in revenue and losses due to a decrease in domestic and international travel. Poor financial position of players and uncertainty over resumption in travel led to delays in project completion which were under implementation in FY21 and capex plans by players as such came to a standstill. The improvement in operational as well as financial parameters with each passing quarter from H2 FY22 onwards encouraged players to take up the completion of the projects which were already under implementation but stalled due to the outbreak of Covid.

India currently has approximately 160,000 branded hotel rooms/keys. The industry is expected to add a capacity of approximately 50,000 rooms in the next 5 years with supply registering a CAGR of 4-5% in the said period. Capacity addition in FY24 is expected to be higher compared to the preceding two pandemic years, but it will remain below the pre-pandemic level of FY20. The year 2022-2023 had reasonable supply growth, which mainly consisted of projects in advanced completion which were delayed or stalled due to Covid. The growth of chain-affiliated supply will also occur through conversions that may be 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 Covid.

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 FY27 as the majority of new supply is coming in Upscale, Upper midscale and Midscale/Economy sections. This reduction in supply share is despite new rooms being added in all the segments; 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 a clear focus on quality within key destinations which not only helps them in swiftly building a pool of quality inventory with presence across segments but also aids in 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 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 the creation of a robust demand base, the upcoming supply pipeline currently shows a clear correlation vis-à-vis the upcoming tourism and infrastructure developments.

CareEdge Ratings View

"On the back of the surge in domestic demand and underlying GDP growth, the players in the industry are witnessing strong capacity utilization. With the 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. While the material contribution from international travelers is yet to materialize, currently the domestic demand is the key driver. With the current travel momentum expected to continue and anticipated demand likely to outpace current supply, FY25 is likely to witness steady high occupancies in the range of 68-70% and continued RevPAR growth at 9-11% which shall aid in overall improvement of the credit profile of the players in the industry", said Ravleen Sethi, Associate Director, CareEdge Ratings.

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