

MAHINDRA HOLIDAYS & RESORTS INDIA

MISCELLANEOUS

25 JUL 2016

Annual Report Update

BUY

Target Price: Rs 569

Annual Report: Digging a deeper moat

A reading of the FY16 annual report takes us through the several steps Club Mahindra has taken to generate high quality leads, prioritize prospects and increase conversion. The MD&A starts off with a reiteration of Mahindra Holiday's focus to achieve continued success in its strategic objective: **ensuring that its growing membership gets the best holiday experience**".

MHRL instituted a slew of initiatives to boost its membership growth which continues to remain strong at 9% YoY. While only 63 rooms were added this year, plans to add 500 rooms over the next two years are in place. An exceptional business model (members funding capex & opex), conservative management, and strong on the ground initiatives make MHRL one of our **top midcap ideas**. Maintain BUY with TP of Rs 569 (implies 34% upside).

CMP : Rs 424
Potential Upside : 34%

MARKET DATA

No. of Shares : 89mn
Free Float : 25%
Market Cap : Rs 38 bn
52-week High / Low : Rs 475 / Rs 262
Avg. Daily vol. (6mth) : 49,022 shares
Bloomberg Code : MHRL IB Equity
Promoters Holding : 75%
FII / DII : 9% / 5%

Growth initiatives: MHRL instituted a slew of initiatives to boost the membership growth including (a) Heart to Heart program (carnivals), (b) India Travelogue (TV Show), (c) Shikara rides and Diu beach festivals etc. Membership growth continues to be strong at 9% YoY. On the softer aspects: Improvement in IT offering, targeted marketing, and providing differentiated holiday experience continue to be the key focus of the management. We believe the future success of the company lies upon the successful implementation of these on the ground initiatives which will result in membership growth of ~8% pa at the very least. CM added around 16,200 members (9% YoY growth) to its vacation ownership business in 2015-16 — taking the total membership base to close to two lakh families.

Capex comfort: Most of the cash flows generated domestically were used to fund the 63 room addition, while the incremental debt was utilized to fund the Holiday Homes acquisition. MHRL plans to add 500 rooms both at existing locations and new locations over the next 2 years through internal accruals.

Financial summary (Consolidated)

Y/E March	FY15	FY16	FY17E	FY18E
Sales (Rs mn)	8,119	15,986	22,374	24,662
PAT (Rs mn)	803	1,193	2,216	2,722
Con. EPS* (Rs)	-	-	16.4	19.7
EPS (Rs)	9.2	13.5	25.2	30.9
Change YOY (%)	(6.7)	46.8	85.8	22.9
P/E (x)	46.0	31.3	16.9	13.7
RoE (%)	10.9	17.1	30.8	32.4
RoCE (%)	4.9	6.9	9.1	10.4
EV/E (x)	23.2	14.8	10.1	8.4
DPS (Rs)	4.0	5.0	6.5	8.0

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY15	FY16	FY17E	FY18E
Mem. addn. growth	8%	9%	8%	8%
Mem./Room	65	69	65	65

Price performance

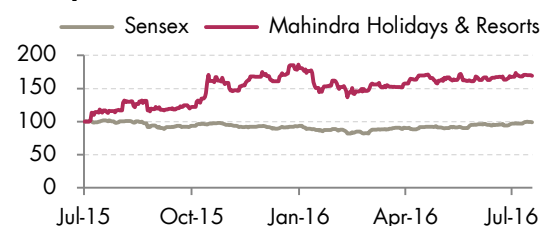
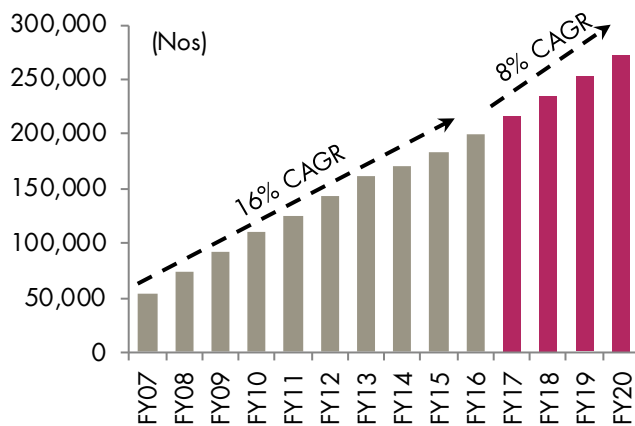
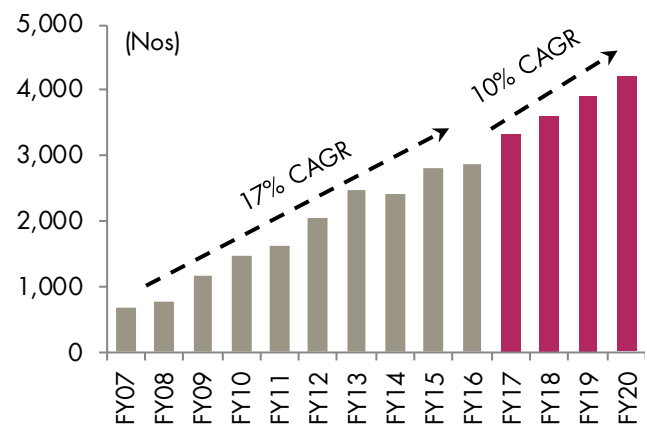


Exhibit 1: Strong membership growth rate


Source: Company, Axis Capital

Exhibit 2: Room addition inline with membership growth


Source: Company, Axis Capital

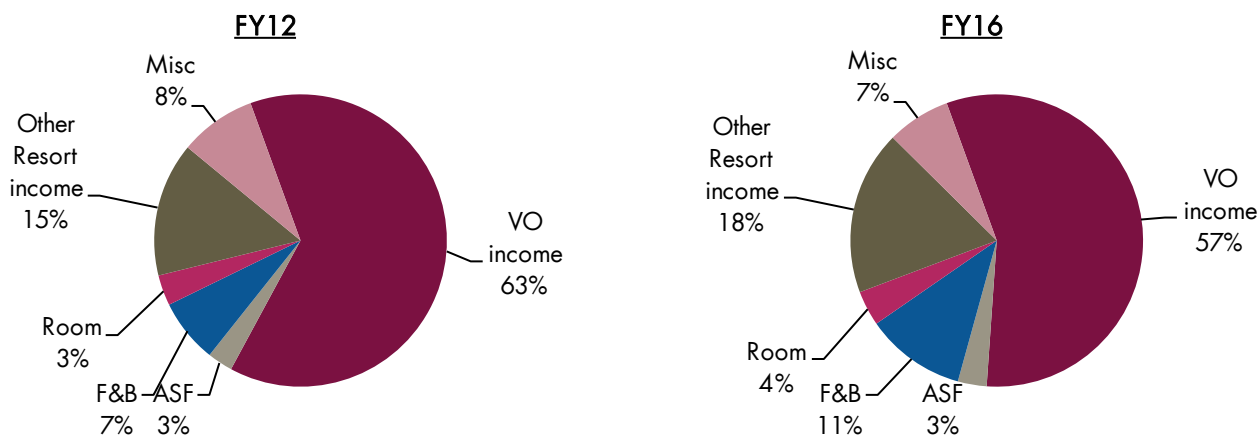
The following is a small gist of the various on-the-ground initiatives taken by CM management to increase customer satisfaction levels and garner more referrals:

- ◆ CM launched 'Heart-to-Heart', a member engagement initiative in their hometowns. Events and activities are being carried out where members and their families meet other members to enjoy various leisure activities. This helps in creating a strong sense of belonging to the 'Club Mahindra' community. This also provides an opportunity to update members, seek referrals and solve any issues they might be facing.
- ◆ 'India Travelogue', a 40-episode weekly TV travel-series is being aired on CNBC Awaaz since September 2015. The series showcases CM's resorts and the experiences that they offer, in the backdrop of the destination's points of interest.
- ◆ To provide customers new vacation experiences, house boats in Kashmir and sea-facing luxury tents at 'Festa De Diu' (the longest beach festival in Asia) were introduced.
- ◆ Other engagement and brand building initiatives during the year included setting-up of a mini Club Mahindra resort facility within 'Kidzania', the kids edutainment centre inside R-City Mall, Mumbai, to give children a sense of what it would be like to work in the hospitality industry.
- ◆ During the year, the company introduced 'Xperience Breaks', which offers one week of holiday each in India and international destinations within a year of purchase. It is designed to provide customers a first-hand experience of Club Mahindra membership and is aimed at younger audience in large towns and cities. It is conceived as an exclusively online product and is being marketed through online partnerships.

As a result of significant on-the-ground efforts, digital and referral leads contributed considerably to sales and now account for over 50% of sales during the year

Analyzing the revenue streams of Mahindra Holidays (given in the pie chart below), we conclude that the annuity income streams continue to gain prominence.

Exhibit 3: Annuity streams gaining prominence



Source: Company, Axis Capital

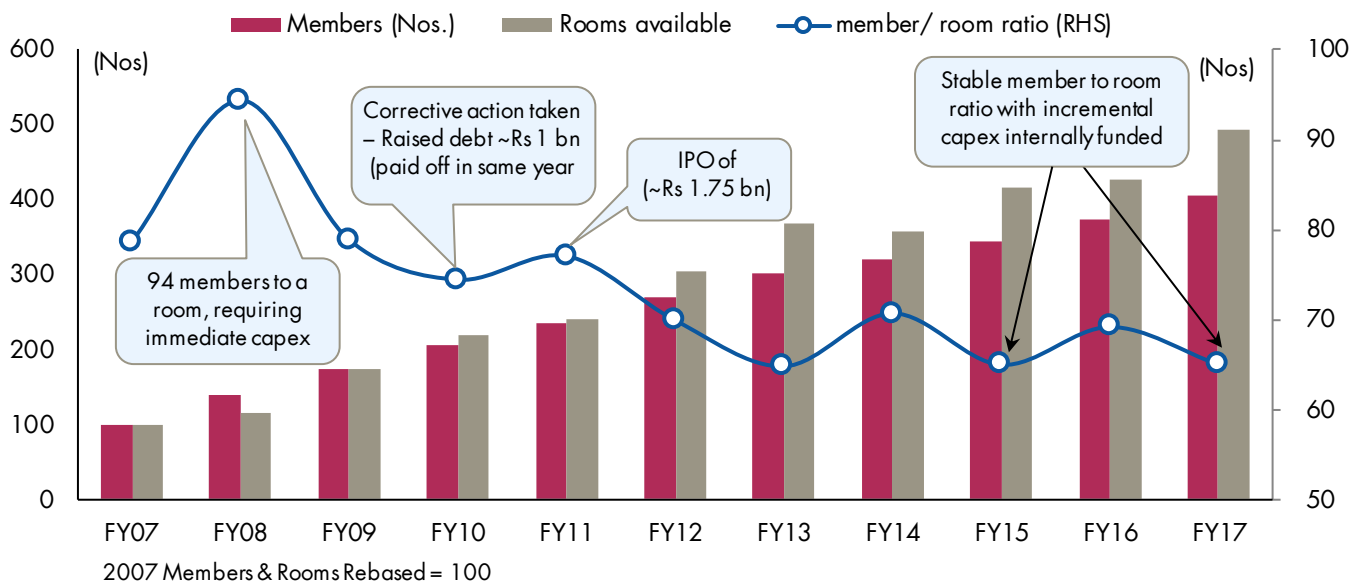
Marketing and brand building: To support the on-the-ground initiatives, the company also carried out extensive advertising and brand-building campaigns in print and television. 'Club Mahindra' was selected as a 'Super Brand' for the year 2015 by SuperBrand Council in India.

Occupancy rates remained stable around 81% and member satisfaction improved considerably, both in terms of member services and the holiday experience at the resorts. These are reflected in improved customer-as-promoter and post-holiday feedback scores.

Providing the right holiday experience: CM has to strike the right balance on the member-to-room ratio as a higher number will lead to dissatisfied customers, while a lower ratio will lead to under capacity. The company has found a sweet spot between 65-70 members to a room and is likely to maintain this going forward. Mahindra Holidays added 87 new units to its room inventory. Total room inventory touched 2,879 units across its 45 resorts. Pace of room inventory growth is expected to increase in the near future in line with its long-term strategy for expansion, primarily through own projects and acquisitions. Four projects that are in the pipeline alone are expected to add around 500 units in the next two years.

'Club Mahindra' was selected as a 'Super Brand' for the year 2015 by SuperBrand Council in India

Exhibit 4: Room addition historically ahead of membership growth, member-room ratio stable in recently years



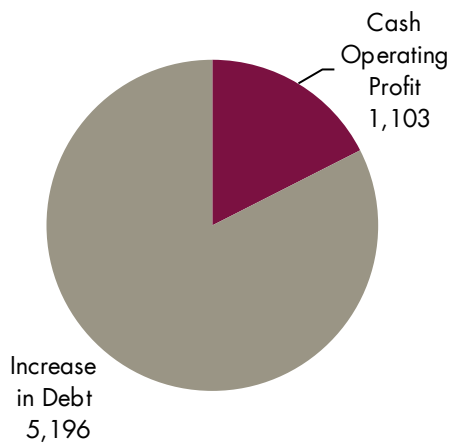
Source: Company, Axis Capital

Increasing room inventory in line with membership additions continues to be a key focus area. The company is currently undertaking four projects: Naldhera (Shimla), Assanora (Goa), Ashtamudi (Kerala) and expansion at Kandaghat (Shimla), which are in different stages of planning and development.

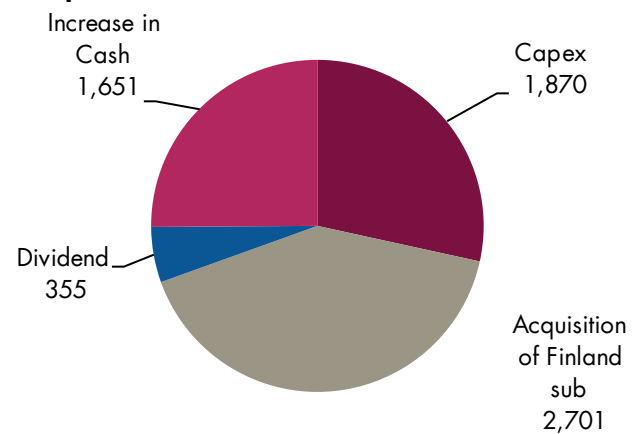
Apart from this, the company also has land bank at nine destinations across six states. Efforts are on to expand this further. Some of its existing resorts also have additional land that can be utilized for further expansion. This will provide the flexibility to build such destinations and add room inventory on an ongoing basis.

Capex and use of operating cashflows: Exhibit on next page indicates the use of generation and use of cash flows. We believe ~Rs 1.1 bn of operating cashflows have been utilized for domestic capex (our estimate of ~Rs 0.9 bn) and dividend payment (~Rs 0.4 bn). Incremental Debt of ~Rs 5 bn was predominantly used for funding the acquisition (~Rs 2.7bn), incremental capex in the Finnish subsidiary (~Rs 0.9 bn) and the balance appears to be held in cash and equivalents (~Rs 1 bn).

Pace of room inventory growth is expected to increase in the near future in line with its long-term strategy for expansion, primarily through own projects and acquisitions. Four projects that are in the pipeline alone are expected to add around 500 units in the next two years

Exhibit 5: Sources of Cash in FY16


Source: Company, Axis Capital

Exhibit 6: CFO utilized for domestic capex, debt funds acquisition


Source: Company, Axis Capital

Back of the envelope calculation shows that the company has spent ~Rs 0.4bn in FY16 with respect to the room inventory which will go live in FY17. This translates into capex requirement for 50-60 rooms.

Exhibit 7: Capex in FY16 reflecting capex requirement for ~55 rooms

Particulars	(Rs mn)
Domestic capex	938
Room addition in FY16	63
Average cost per key for MHRL	8
Theoretical addition in Gross Block	504
Capex incurred for future projects	434
Room inventory already paid for	54

Source: Company, Axis Capital

Awards and accolades: RCI's 'Gold Crowns' for outstanding resort properties continue to shower down along with accolades from Trip Advisor and Holiday IQ. With four of the company's resorts upgraded to Gold Crown during 2015-16, it has a unique distinction of having 26 RCI Gold Crown and 2 Silver Crown resorts in India, which bear testimony to the high standards of facilities, amenities and services that its resorts offer. During the year, five resorts won the Platinum Award from RCI. In addition, the resort at Gangtok received the prestigious 'Best Resort (Hospitality)' award from Government of Sikkim.

Average rating of 4 (out of 5) for all resorts on Trip Advisor

Resort	Trip Advisor rating	% of Average/Poor/ Terrible reviews	Resort	Trip Advisor rating	% of Average/Poor/ Terrible reviews
Puducherry	4.0	22%	Gangtok	4.0	18%
Danish Villa, Ooty	4.0	17%	Baiguney, Sikkim	4.0	9%
Yercaud, Tamil Nadu	4.0	31%	Mussoorie	3.5	32%
Derby Green, Ooty	4.0	19%	Naukuchiatal, near Nainital	4.0	22%
Kodaikanal	4.0	16%	Binsar Valley, near Nainital	4.0	15%
Le Poshe, Kodaikanal	4.5	6%	Corbett, near Nainital	4.0	17%
Masinagudi, near Ooty	4.0	30%	Kanatal, near Dehradun	4.0	20%
Madikeri, Coorg	4.5	11%	Mashobra, near Shimla	4.0	26%
Virajpet, Coorg	4.0	17%	Manali	4.0	20%
Jaisalmer	4.0	19%	White Meadows, Manali	4.0	20%
Kumbhalgarh, near Udaipur	4.5	12%	Kandaghat, near Shimla	4.0	17%
Udaipur	4.0	24%	Dharamshala	4.0	32%
Emerald Palms, Goa	4.0	21%	Kumarakom	3.5	47%
Acacia Palms, Goa	4.0	18%	Cherai, Kerala	4.0	15%
Varca Beach, Goa	4.0	21%	Munnar	4.0	14%
Sherwood, Mahabaleshwar	4.0	29%	Mount Serene, Munnar	4.5	0%
Gir, Gujarat	4.0	16%	Ashtamudi, Kerala	4.5	11%
Bon Alpina, Austria	4.0	24%	Thekkady, Kerala	4.5	39%
Arabian Dreams, Dubai	3.5	31%	Poovar, Kerala	4.0	25%
Mac Boutique Suites, Bangkok	3.5	42%			

Source: Tripadvisor, Axis Capital

The resort in Coorg received '2016 Traveller's Choice Hotel Award' under the category 'Top Hotels for Families – both Asia and India'; resort in Munnar received '2016 Traveller's Choice Hotel Award' under the category 'Top Hotels for Families – India'; and resort in Thekkady received 'Holiday IQ Award' for 'Top Hotel Chain' and 'Top Excellent Services'.

Improvement of the IT platform: During 2015-16, the management took significant strides to ensure seamless online booking and redressal. Consequently, the percentage of online bookings increased to 66 in 2015-16, up from 52 in the previous year. In absolute terms, online bookings increased by over 75,000 during the year. Better online services have increased the transparency and efficiency of booking process, thereby contributing to a superior member experience. Reservation and payment related grievances also came down significantly.

The company launched an upgraded website on a cloud-based architecture, which increased availability, speed, and peak load handling capacity. For members, a host of features were added:

- ♦ online payments using NEFT and e-wallets
- ♦ waitlisted bookings
- ♦ online referral
- ♦ exclusive online offers

During the year, the company made significant progress in its bid to integrate its CRM, Web and SAP-based systems – with the ultimate aim of having a unified view of the customer throughout his engagement with the company. For instance, this integration has paved the way for the company to develop a full-feature mobile app for its members, which is expected to be launched in 2016-17.

The company also launched a micro-site for its new one-year product 'Xperience breaks', which allows customers to view and buy the product online

Integration of CRM, WEB and SAP-based systems has paved the way for the company to develop a full-feature mobile app for its members, which is expected to be launched in 2016-17

Direct sales network: The company was also successful in expanding its sales network during the year. At the end of 2015-16, it was present in 137 locations in India vs. 124 in the previous year. Its focus on international markets with sizeable Indian population also saw significant progress, with deepening of its presence in the Middle East by way of two new locations. Contribution of international markets to sales, which was negligible a few years back, also increased to 4% in the year.

Going forward, focus will be to expand the footprint, both in India and abroad, as well as to explore alternate channels that are in line with the company's strategy.

Acquisition of Holiday Club, Finland: Mahindra Holidays increased its stake in Holiday Club Resorts Oy, Finland (HCR), to 85.6%. Management believes "this investment is in line with the Company's vision to widen its international footprint and opens up growth opportunities in Europe and Middle East. Besides, 'Club Mahindra' members will now also have the option of visiting HCR's resorts in Europe."

HCR is a leading vacation ownership company in Europe with around 50,000 members and 31 resorts in Finland, Sweden and Spain. HCR has 31 resorts, of which 23 are located in Finland, 2 in Sweden and 6 in Spain. HCR operates 1,159 hotel rooms and 2,173 holiday homes (Time share units and villa units). For 7 months that the company was a subsidiary of MHRL, the company generated revenue of €88 mn (~Rs 6 bn) and PAT of €3.2 mn (~Rs 200 mn). For the full year, the holiday homes declared revenue of ~Rs 12 bn and net loss of ~Rs 280 mn.

Our Investment Thesis on the stock

Customers' value proposition stems from (a) Promise of inflation protected holidays for 25 years and (b) Delivery of 'family holidays' at pristine locations.

As a result, 80% of the members visiting resorts have rated their experience as above average (source: Trip Advisor)

Exceptional business model with members funding the capex and the opex. Club Mahindra generates surplus both at the HO and the resort level. Post the tenure of membership, CM can resell the same property to new members - generating CFO with negligible capex.

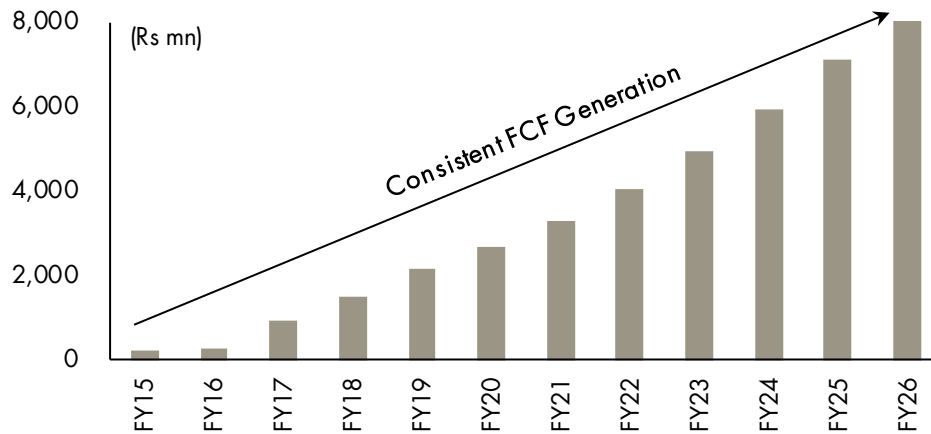
Over the last 5-7 years, **income and expenditure streams getting more granular**. Annuity-based income gaining prominence.

Stability in the member/ room ratio FY16 onwards will lead to significant free cash generation going forward.

We continue to believe in the exceptional business model of the company with both the capex and opex being funded by the member. At the current member-room ratio of 65-70, we believe the company is well poised to generate steady free cash. We have a BUY rating on the stock with DCF-based target price of Rs 569.

CM's focus on international markets with sizeable Indian population also saw significant progress, with the contribution of international markets to sales, which was negligible a few years back, also increased to 4% during the year

Exhibit 8: Unique business model enables consistent free cash generation



Source: Axis Capital Research

Exhibit 9: Valuation and key assumptions

Key assumptions		(%)
Riskfree rate		8%
Market risk premium		5%
Beta		1.0
Discounting rate		13%
Terminal growth		5%
Valuation		(Rs mn)
PV of FCF		19,528
Terminal value		37,607
Value of the company		57,135
Debt		7,046
Equity value		50,089
CMP (Rs)		424
Per share value		569
Upside		34%

Source: : Axis Capital Research

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Net sales	8,119	15,986	22,374	24,662
Other operating income	-	-	-	-
Total operating income	8,119	15,986	22,374	24,662
Total operating expenses	(6,449)	(13,033)	(18,095)	(19,577)
EBITDA	1,670	2,953	4,278	5,085
<i>EBITDA margin (%)</i>	<i>20.6</i>	<i>18.5</i>	<i>19.1</i>	<i>20.6</i>
Depreciation	(664)	(975)	(1,244)	(1,349)
EBIT	1,006	1,978	3,034	3,737
<i>Net interest</i>	<i>(111)</i>	<i>(244)</i>	<i>(239)</i>	<i>(212)</i>
Other income	178	52	116	122
Profit before tax	1,073	1,786	2,911	3,647
Total taxation	(270)	(594)	(696)	(924)
<i>Tax rate (%)</i>	<i>25.2</i>	<i>33.2</i>	<i>23.9</i>	<i>25.3</i>
Profit after tax	803	1,193	2,216	2,722
Minorities	10	-	-	-
<i>Profit/ Loss associate co(s)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
Adjusted net profit	812	1,193	2,216	2,722
<i>Adj. PAT margin (%)</i>	<i>10.0</i>	<i>7.5</i>	<i>9.9</i>	<i>11.0</i>
Net non-recurring items	-	-	-	-
Reported net profit	812	1,193	2,216	2,722

Balance sheet (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Paid-up capital	880	881	881	881
Reserves & surplus	6,371	5,820	6,830	8,203
Net worth	7,251	6,701	7,710	9,084
Borrowing	1,238	7,046	6,296	5,546
Other non-current liabilities	16,756	19,214	21,006	23,166
Total liabilities	27,680	38,556	41,076	44,435
Gross fixed assets	12,949	19,355	21,880	23,599
Less: Depreciation	(2,633)	(5,940)	(7,184)	(8,533)
Net fixed assets	10,315	13,415	14,696	15,067
Add: Capital WIP	946	753	793	809
Total fixed assets	11,261	14,168	15,489	15,875
Other Investment	-	-	-	-
Inventory	60	4,580	4,809	5,049
Debtors	8,714	10,925	12,224	14,053
Cash & bank	221	1,124	588	560
Loans & advances	396	794	420	505
Current liabilities	2,436	4,844	5,313	5,888
Net current assets	6,951	12,578	12,726	14,278
Other non-current assets	5,601	6,362	6,943	7,788
Total assets	27,680	38,556	41,076	44,435

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Profit before tax	1,073	1,786	2,911	3,647
Depreciation & Amortisation	(664)	(975)	(1,244)	(1,349)
<i>Chg in working capital</i>	<i>442</i>	<i>(655)</i>	<i>526</i>	<i>(264)</i>
Cash flow from operations	2,020	1,251	3,479	3,248
<i>Capital expenditure</i>	<i>(1,799)</i>	<i>(938)</i>	<i>(2,565)</i>	<i>(1,735)</i>
Cash flow from investing	(3,085)	(129)	(2,449)	(1,613)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>(750)</i>	<i>(750)</i>
<i>Dividend paid</i>	<i>(355)</i>	<i>(355)</i>	<i>(577)</i>	<i>(700)</i>
Cash flow from financing	767	(476)	(1,565)	(1,663)
Net chg in cash	(298)	646	(536)	(27)

Key ratios

Y/E March	FY15	FY16	FY17E	FY18E
OPERATIONAL				
FDEPS (Rs)	9.2	13.5	25.2	30.9
CEPS (Rs)	16.8	24.6	39.3	46.2
DPS (Rs)	4.0	5.0	6.5	8.0
Dividend payout ratio (%)	43.7	37.2	26.0	25.7
GROWTH				
Net sales (%)	(0.5)	96.9	40.0	10.2
EBITDA (%)	0.2	76.9	44.9	18.9
Adj net profit (%)	(6.6)	46.8	85.8	22.9
FDEPS (%)	(6.7)	46.8	85.8	22.9
PERFORMANCE				
RoE (%)	10.9	17.1	30.8	32.4
RoCE (%)	4.9	6.9	9.1	10.4
EFFICIENCY				
Asset turnover (x)	1.1	1.5	1.6	1.7
Sales/ total assets (x)	0.3	0.5	0.6	0.6
Working capital/ sales (x)	0.8	0.6	0.5	0.5
Receivable days	391.7	249.4	199.4	208.0
Inventory days	3.4	128.3	97.0	94.1
Payable days	63.2	97.8	76.8	77.6
FINANCIAL STABILITY				
Total debt/ equity (x)	0.2	1.0	0.8	0.6
Net debt/ equity (x)	0.1	0.8	0.7	0.5
Current ratio (x)	3.9	3.6	3.4	3.4
Interest cover (x)	9.1	8.1	12.7	17.6
VALUATION				
PE (x)	46.0	31.3	16.9	13.7
EV/ EBITDA (x)	23.2	14.8	10.1	8.4
EV/ Net sales (x)	4.8	2.7	1.9	1.7
PB (x)	5.1	5.6	4.8	4.1
Dividend yield (%)	1.0	1.2	1.5	1.9
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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