Leisure, Gaming and Lodging/India
IPO Grading Report

Mahindra Holidays & Resorts India Limited

Fitch IPO Grade 4(ind)

Fitch has assigned a grade of '4 (ind)' out of a maximum of '5 (ind)' to the proposed initial public offer of Mahindra Holidays & Resorts India Limited (MHRIL). The grade indicates the above-average fundamentals of the issue relative to other listed equity securities in India

IPO Details

Mahindra Holidays & Resorts India Limited proposes an IPO of its 92,65,275 equity shares of INR 10 each. This includes an offer for sale of 33,69,191 shares by Mahindra & Mahindra Ltd (promoter)

Financial Snapshot

(INRm)	2009	2008
Revenues	3,931	3,527
EBITDA	1,530	1,420
EBIT	1,364	1,313
Net income	834	805
Total adjusted debt	2,193	915
Shareholders funds	1,980	1,430
EBITDA margin (%)	39	40
EBIT margin (%)	35	37
Net income margin (%)	21	23
Earnings per share	10.6	10.3
Total adjusted debt/equity	1.2	0.6

Source: Company, Fitch

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Shareholding pattern

	Pre issue (m)		Post issue (m)	
	No. of shares	(%)	No. of shares	(%)
Promoters	73.4	93.6	69.9	83.1
Employee stock option scheme trust (ESOS)	1.3	1.7	1.3	1.6
State Bank of India	1.6	2.1	1.6	1.9
Nylim Jacob Ballas India	0.8	1.1	0.8	1.0
Employees (including employees of group companies) and directors	1.2	1.5	1.2	1.4
Pubic	-	-	9.3	11.0
Total	**78.3**	**100.0**	**84.2**	**100.0**

Source: Company, Fitch

Grading Rationale

The grading assigned to Mahindra Holidays & Resorts India Limited (MHRIL) is underpinned by the company's established presence in the leisure holidays business in India. The grading also factors in the strong promoter background and advantages of the "Club Mahindra" brand that MHRIL has created for its flagship product offering. The business of MHRIL, which is aimed at the domestic urban market, has been supported by changing demographics, strong economic growth, and increasing disposable incomes in India over the last three years. The domestic travel and tourism industry has also been boosted by the increasing investment in infrastructure, such as roads, and the penetration of low-cost airlines.

MHRIL has seen increasing revenue and improving EBIDTA margins over the last four years, and the member base for "Club Mahindra" has increased to 91,946 as of 31 March 2009. MHRIL is currently the largest player in the industry, with few competitors. The financial commitment required for creation of an inventory of resorts, and the efforts involved in brand building, has created a considerable entry-barrier to MHRIL's operating segment.

Fitch expects the domestic economy to continue to grow, which will help MHRIL's performance. Future member additions could be affected by a slowdown in economic growth, and, as spend on leisure activities is largely dependent on disposable income; MHRIL's revenue growth could be adversely affected. As MHRIL's business is largely based on establishing direct contact with consumers, and considering that about 35% of new member additions in FY09 came from referrals by existing members, MHRIL's ability to manage these relationships could be a key factor for future revenue generation. Members, several of whom make monthly payments for membership charges over a 6-month to 4-year period, deciding not to continue with membership may also affect future revenue generation.

The proceeds from MHRIL's proposed issue are expected to be deployed in the construction of new resorts and expansion of existing ones, to provide a larger range of resorts, and hence a wider choice of holiday destinations to members.

Key Grading Issues

Areas of Strength

- Established position in its business segment, with strong parentage and brand image

- Growth in the travel and tourism segment in India, aided by strong economic growth over the last few years
- Healthy operating margins

Areas of Concern

- Future member additions could be affected by overall economic growth
- As a significant portion of new members make payments in instalments, the company is exposed to individual credit risk

Company Background

MHRIL was founded in 1996 as "Mahindra Holidays & Resorts Private Limited", and was converted to a public limited company in 1998. MHRIL is an established player in the leisure hospitality segment, and provides holidays through vacation ownership memberships. The members enrolled for the company's offerings can reside at resorts in a range of locations, for a pre-determined number of days for a fixed period.

The company has an integrated business model, and its activities include acquisition of members, servicing of members and maintaining contact with them, identification of locations and land for resorts, and developing and operating resorts. MHRIL's members can also choose to access a range of resorts through its tie-up with Resort Condominiums International (RCI).

As of June 09, the company offers stays at 27 resorts, which include 11 owned and 16 leased resorts.

Promoters

MHRIL is part of the Mahindra Group, and was promoted by Mahindra & Mahindra Limited and Mahindra Holdings and Finance Limited. Majority of the shareholding (93.6%) is held by Mahindra & Mahindra Limited (M&M). The employee stock option scheme trust (ESOS) holds 1.7% of the share capital, with employees (including employees of group companies) and directors holding 1.4%. MHRIL has made a pre-IPO placement with State Bank of India and Nylim Jacob Ballas India Fund III, LLC, which hold 2.11% and 1.05%, respectively, of the equity share capital. This placement has been made at INR479 per equity share.

The company has a management team that is well qualified and experienced in the industry. As of 31 May 2009, the company had a qualified, skilled and trained workforce of 638 employees at its offices and 944 employees at the resorts.

Competition

While there are other players in the vacation ownership industry in India, MHRIL is the most recognised player in the industry — and the largest among them. Competitors include companies like Sterling Holiday Resorts (India) Limited.

While other competitors could emerge, Fitch believes that MHRIL's brand, inventory and distribution of resorts and its integrated model, combined with the company being an early mover in the industry, will give it significant competitive advantage.

In addition to domestic competitors, the increasing popularity of international travel may also intensify the level of competition.

India's economic growth, and the enhanced purchasing power across the middle class-income segments,, has also led to the increasing penetration of luxury goods in the country, vying for a share of disposable income.

Business Overview

MHRIL's resorts offer the use of furnished accommodation, such as apartments and cottages; facilities such as restaurants; and a range of activities. The company has a mixed-use model for utilisation of its resorts, also providing non-members access to unutilised apartments on a per-night tariff basis. MHRIL retains the ownership of its resorts, offering members the "right to use" these resorts.

The company currently has three offerings: Club Mahindra Holidays, Club Mahindra Fundays and Zest.

Club Mahindra Holidays is the flagship service offering of the company. Membership here enables members to holiday at any of its 23 resorts, for seven days each year, for a period of 25 years. The membership fees depend on the type of accommodation and season of holiday chosen. This offering is aimed at couples in the 35-50 age groups.

Club Mahindra Fundays is the corporate offering of the company, which is a point-based system of 10 years' tenure. Corporates can purchase these points from MHRIL and allow their employees to use these points for holidays. MHRIL does not allow use of its resorts for corporate conferences.

Zest is the short-break holiday product from MHRIL, which provides holiday options of six nights a year in 2-3 day breaks, over a period of 10 years. This product is aimed at individuals and young couples in the 29-35 age brackets. Launched in 2006, it currently has around 2,172 members.

In addition, MHRIL has tied up with RCI, which is among the largest vacation exchange companies in the world. This includes a travel website, www.clubmahindra.travel, and a programme where MHRIL members can access RCI resorts worldwide, which includes around 4,192 resorts (complementary membership for three years for Club Mahindra members, thereafter by paying an additional amount).

The membership fee payable by MHRIL's members comprises a non-refundable admission fee towards enrolment, and an entitlement fee towards provision of entitlements through the membership period. MHRIL also offers financing options up to tenure of 60 months, where membership fees are paid in Equated Monthly Instalments (EMIs).

Financial Performance

Revenue accrues from membership fees (one-time fee collected from customers), annual subscription fees, and resort income such as from food and beverage sales (recurring income from members), room tariffs paid by non-members, and other income such as income on cancellation and interest income.

MHRIL incurred losses prior to financial year 2003 (FY03), and had carried forward losses on its balance sheet up to FY05. However, revenue has grown strongly over the last four years, with a 50%+ increase annually between FY06 to FY08. In FY09, growth clocked 11%, while this was much lower in the second half. MHRIL was significantly impacted by the overall economic slowdown during Q309.

As MHRIL recognises 60% of the membership fees in the first year, with the balance amortised over the period of membership, the increase in revenue is directly correlated to the increase in members. As a significant percentage of new members make payments in EMIs, this has resulted in a high level of sundry debtors (INR4,842m as at 31 March 2009).

The increased membership has also contributed to the healthy profit margins over the last three years. The EBIT margin increased from 23.7% in FY06 to 30.4% in FY07 — and further to 37.2% in FY08. However, in FY09 the EBIT margins have come down to 34.7%, largely due to higher customer acquisition cost. Earnings p per share (EPS) has increased from INR5.6 in FY07 to INR10.6 in FY09. The company, meanwhile, paid out its first dividend in FY07. MHRIL has also seen improving returns on average capital employed, reaching 38% in FY09.

The debt/equity ratio has been improving over the last three years, with total debt/equity at 0.12x in FY09. However, MHRIL had off-balance sheet debt of INR2192m, which consisted of receivable securitised with recourse. Considering the same, the total adjusted debt/equity was 1.2x in FY09.

Outlook

The continued growth of the Indian economy would facilitate increased memberships — and hence strong revenue growth and accretion to shareholder wealth in the long term. However, in the short-term, new member additions could slow down due to slowing economic growth, as witnessed in H209. At the same time, delinquency rates would be higher than in earlier years. MHRIL has significantly increased its member base over the last two years, which will provide stability of revenue streams through annual subscription fees and income from utilisation of resort facilities. The wider range of resorts that MHRIL has planned would help the company attract and retain members.

Annex 1 – Financial Performance

Financial Summary

(INRm)	FY09	FY08	FY07	FY06	FY05
Income statement					
Revenues	3,930.64	3,527.3	2,323.06	1,527.22	1,017.08
Revenue growth	11.43	51.83	52.10	50.15	43.52
EBIT	1,364.26	1,312.6	706.94	361.34	195.76
Interest expense net of interest income	70.29	33.00	35.99	33.23	43.12
Net income	834.08	805.3	425.35	200.40	83.04
Balance sheet					
Cash and equivalents	319.65	76.3	93.55	77.48	39.19
Total assets	10,049.43	7,470.8	4,778.48	3,438.10	2,358.21
Short-term debt	246.29	198.4	55.02	135.86	56.45
Senior long-term debt	0.64	2.20	4.60	132.19	176.30
Subordinated debt	0	0	0	0	0
Total debt	246.94	200.60	59.62	268.05	232.76
Off-balance sheet debt	2,192.88	1,124.62	838.20	486.63	482.36
Total adjusted debt	2,439.82	1,325.22	897.82	754.69	715.12
Preferred stock + minority interests	0	0.30	0.37	0	0
Common equity	1,979.50	1,430.30	756.84	433.11	232.61
Total adjusted capitalisation	4,419.33	2,755.82	1,655.04	1,187.80	947.73
Cash flow					
Operating EBITDAR ("op. EBITDAR")	1,600.76	1,443.441	804.249	466.22	273.05
Cash interest paid, net of interest received	70.29	33	36	33.24	43.12
Cash tax paid	395.09	439.6	97.5	44.28	13.67
Associate dividends	0	0	0	0	0
Other changes before funds from operations[b]	-552.54	-235.041	-82.899	-63.52	-54.58
Funds from operations	582.81	735.8	587.85	325.17	161.67
Working capital	864.55	-303.2	66.6	31.63	164.49
Cash flow from operations	1,447.37	432.6	654.45	356.80	326.16
Non-operational cash flow[a]	-4.02	10.1	-58.36	45.13	0.02
Capital expenditure	1,561.08	731.9	472.889	439.0	220.20
Dividends paid	163.480	101.6	0	0	0
Free cash flow	-281.22	-390.8	123.201	-37.07	105.97
Receipts from asset disposals	2.679	20.6	2.23	1.66	1.03
Business acquisitions	0	0	0	0	0
Business divestments	0	0	0	0	0
Exceptional & other cash flow items	471.08	208.9	80.49	38.38	44.12
Net cash in/outflow	192.54	-161.3	205.92	2.98	151.13
Equity issuance/(buyback)	4.24	2.9	18.9	0	0
FX movement	0	0	0	0	0
Other items affecting cash flow[b]	0	0	12.6	3.3	2.9
Net cash flow available for financing	196.78	-158.4	237.42	6.28	154.03
Closing net debt	-72.71	124.3	-33.92	190.58	193.57
Profitability					
Op. EBITDAR/revenues (%)	40.72	41.72	34.62	30.52	26.84
EBIT/revenues (%)	34.70	37.21	30.43	23.66	19.24
FFO return on adjusted capital (%)	16.39	29.76	39.39	32.42	23.31
Credit ratios					
Funds from operations/gross interest expense (x)	9.29	23.32	17.33	10.78	4.74
FFO fixed charge cover (x)	5.11	9.73	10.17	6.41	3.72
Op. EBITDAR/net fixed charges (x)	11.31	17.45	12.55	7.768	4.60
FFO adjusted leverage (x)	3.36	1.62	1.37	1.95	3.23
Total adjusted debt net of cash/op. EBITDAR (x)	1.32	0.85	1.00	1.45	2.47
Total adjusted debt/total adjusted capitalisation (%)	55.20	48.09	54.24	63.53	75.45

Source: Fitch