“Mahindra Holidays & Resorts India Limited Q2 FY-17 Earnings Conference Call”

October 28, 2016

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Moderator: Ladies and gentlemen, good day and welcome to the Mahindra Holidays & Resorts India Limited Q2-FY17 earnings conference call. We have with us today Mr. Kavinder Singh, Managing Director and Chief Executive Officer, and Mr. Vasant Krishnan, Chief Financial Officer and Executive Director. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kavinder Singh. Thank you and over to you, sir.

Kavinder Singh: Good evening ladies and gentlemen. Welcome to the Q2-FY17 Investor Call for Mahindra Holidays. I am pleased to report a 22% increase on our profit after tax for the quarter-ended September at Rs. 32.8 crores, up from Rs. 26.9 crores in the same quarter last year.

Our member addition continued to be robust. During the quarter, we clocked 4,314 members, up from 3,630 members in Q1, which is a sequential growth of 19%. At a year-to-date level, the growth in member additions at 7,944 units as compared to 7,428 units is a 7% growth over the same period last year. As you know, I have been outlining several measures that we have been taking with regards to member engagement; these measures are being pursued with full vigor and we have recorded significant growth in resort occupancies, which stood at 80% in our resorts in Q2.

Resort income continues to grow steadily; for the quarter-ended September 2016, it stood at Rs. 39.5 crores, up 8% from Rs. 36.5 crores same quarter a year ago. New dining options and holiday activities are of course helping us drive member engagement and occupancies. Our resort occupancies for H1 stand at about 85%, which is the highest ever that we have seen in the recent past. In an endeavor to deepen member engagement outside resorts and also create immersive experiences for our members, we have taken a stake of about 12% in a company called Nreach Online Solutions Private Limited.

The brand Giftxoxo is a fairly-famous brand. They are in the business of curating unique immersive experiences and our aim is to leverage the synergy between the work they do and the work we do. At the end of the day, we are all in experiences businesses.

Our positive mentions on social media are growing significantly. We are finding that there is a significant improvement in Trip Advisor reviews. We have also shared with you about the initiatives that we have taken in digital. This is in terms of sourcing the leads i.e digital alliances and referrals, and these continue to be our focus areas and members coming from this would remain steady at 50% plus.

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We normally talk about these leads as full leads. These are the leads which come to us almost on their own and we drive this agenda to ensure that our proposition is valued amongst the prospects who come to us looking for memberships.

Our increase in member base is also resulting in healthy growth of AFS income, which is up 22.2% to Rs. 55 crores from Rs. 44.8 crores in the same quarter last year. This has been largely driven by volume increase. So, to sum it up, the total revenue came in at Rs. 261 crores, up by 10% from Rs. 237.1 crores same period last year.

Because of the cost management actions and initiatives that we have been driving, the EBITDA number came in at Rs. 64.4 crores from Rs. 57.2 crores, which is 12.6% increase on year-on-year basis and operating margins at 24.7% have improved from 24.2% in the same period last year.

I would now turn the floor open to questions to me and my colleague Vasant Krishnan, who is the CFO and Executive Director. Thank you very much.

Moderator: Thank you very much. We will now begin the question-and-answer session. We have the first question from the line of Mr. Nihal Jham of Edelweiss Securities. Please go ahead.

Nihal Jham: My first question was on member addition. While I see growth is robust on a QoQ basis, looking at the trend, on a yearly basis, it is flat. So just wanted your comment on that. And, secondly, could you elaborate a little more on your recent acquisition and how do you plan to integrate and use it to drive your member addition, going ahead?

Kavinder Singh: As far as your first question goes in terms of nearly flat member additions, we are not worried. The reason is that you know that last year this number was 4,341, a 50% growth on year-on-year terms; hence, last year we grew 50%. So, we have now a very high base and, on sequential basis, we have grown 19% and since we are seeing all metrics which are operating metrics whether it is member engagement, member satisfaction, member holidaying as well as the sales funnel. .

We are not concerned about these flat member additions. Because please note that we have a 25-year product and the contribution from each of these members over that period is a significant source of income for us. So it is perfectly fine from that perspective. And as far as your second question on Nreach Online, our objective of taking stake of about 12% in this company was to understand how the new-age consumers as we call Millennials are consuming experiences. The more we understand how they are consuming experiences, the more we can create these experiences or curate these experiences in our resorts. Equally, it gives an opportunity for the acquired company, which is a startup, to gain customer insights by seeing how our members consume experiences.

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So we do see a huge synergy between the two of us and the other thing is that we would like to offer our members experiences round the year in their own cities where they stay through these platforms which is a platform of Nreach Online the brand called Giftxoxo. So we intent creating these synergies so that we are able to engage with our members round the year and therefore we hope to get life time value out of these 25 years' relationship that we have with our members.

Moderator: Thank you. The next question is from the line of Sumant Kumar of Elara Securities. Please go ahead.

Sumant Kumar: Sir, when you talk about entry synergy, could you please elaborate more about that?

Kavinder Singh: I did explain but I will elaborate if you want little more. See Giftxoxo is in the business of gifting experiences. So it is actually a market place for experience providers and of course it curates experiences because there is no real supply of experiences. It creates experiences and it gets suppliers to list them online. It has a significant business in the B2B sector where it is using this platform for employees to use these experiences and lot of employers are using it to give reward and recognition to their existing employees. So, this is the model in which it works and it also has significant retail presence in terms of number of visitors that come on its website and consume experiences.

Our aim is to be able to understand the way people consume experiences, the new generation, the millennials, the way they consume experiences and curate a similar kind of experience in our resorts and they will have access to our 200,000 members to be able to offer them some unique experiences. We believe this will lead to a cycle of engagements around the year with our members thereby increasing our vessels and hopefully increasing our member acquisitions.

Sumant Kumar: What are the reasons for increase in other business?

Vasant Krishnan: What do you mean by other business, you mean other operating income?

Sumant Kumar: Yes, other operating income.

Vasant Krishnan: Other operating income that is largely the interest on installments sales came in at Rs. 25 crores. If you look at how we compute the interest income, it is the income that we get from the members and, from that, we reduce the interest that we pay on our securitized loans. And for quarter ending 30 September 2015, the interest on securitization loan was nearly three times that of securitization loan interest that we had to pay and bear this quarter. And this is a reflection of the loan that is coming down and an improvement in our collection efficiency, all of which is now starting to play out as far as that interest line is concerned.

Sumant Kumar: So your liability has reduced, right?

Vasant Krishnan: Yes, absolutely. Our outstanding liability is now around Rs. 30 crores.

Sumant Kumar: So that is why there is a higher other operating income?

Vasant Krishnan: That is right.

Sumant Kumar: And what plan do we have for room addition?

Vasant Krishnan: Room addition, over the next two years, should be on track; we expect to add at least 600 rooms of our own, in addition to which very aggressive land banking is in progress. In all areas where we have seen demand in terms of our member profiling at one level. And of course leases and inventory arrangements that we continue to do depending upon our need, we will selectively use that option and leverage on that as an option to increase room inventories.

Sumant Kumar: So will the room addition for FY17 be 600 rooms?

Vasant Krishnan: Not FY17. Over the next two years.

Sumant Kumar: The membership addition currently is flat and the run rate is 17.5%. So, what is our expectation going forward? Will it increase? Currently it is flat. So what is the outlook?

Vasant Krishnan: Outlook is something that we never give. But I think Kavinder has already said that the number of initiatives that he is taking in terms of digital and other certain programs and member engagement with heart to heart; it is not elaborated this time but I think he has spoken about it at a number of other fora with all of you. All of that should result in the outcomes that we seek. But in terms of an actual number and outlook, we do not really give that out.

Sumant Kumar: Revenue contribution is from income in sale of vacation ownership and it is around 60%. Hence, there will be no volume growth in membership addition growth and we are not increasing price also currently. So how will growth come for the topline?

Kavinder Singh: So our growth on the topline does not come only from vacation ownership income. As you know, we have other annuity incomes we get from the members that have been acquired in the past. The advantage of our model is that as you know there is a 60% revenue recognition that we do and 40% of the revenue comes from the annuity income from those who are already our members. And this happens every quarter, it is not that it happens once in a while. Till that 40% kick-up that comes, there is an annual subscription fee, there is an interest income and there is a resort income.

As you can see our resort income has moved up by about 8%. Constantly seeing growth in all the streams of income. Vacation membership income is one part of the income. But what is

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important for is to add members over a period of time not necessarily growing quarter-on-quarter but to ensure that, at least, on a cumulative basis, our base keeps on growing. Our base has been growing at about 8% to 9% and that growth alone is sufficient for us to be able to ensure that our topline keeps growing and as you can see that even in this quarter our income has grown by about 10% and our profits have grown.

So this is largely because of the fact that we are able to grow other sources of income even if the VO income is flat; the other sources of income are available. With regards to guidance, the reason we do not give guidance is because we have a very fundamental belief that we would like to focus on the inputs and member addition is a function of whatever we have done. So we constantly focus on member engagement, we want our members to holiday with us and we are very happy that our occupancies are at an all-time high.

We find the resort incomes going up. We find that there is significant interest in our product as reflected in a 19% sequential growth. As I told you, the last year this quarter we had grown 50% so we are on a high base and that is why seeing flat growth. I have made that as a statement in the first question itself. With regards to volume growth, if you really want to know our intentions as to how we will grow the business, please look at the number of units that we are adding. That is a very good surrogate as to how we are looking at volumes in the future. Because we would not be adding units if we were not confident on our volume growth.

Sumant Kumar: Regarding the realization growth, the realization per membership, can we assume 1% because of the flat growth you have in revenue?

Kavinder Singh: I just want to also mention that please understand that we have done price increases twice already in the last one year. So it is not that we have not been doing price increases. We judicially increase prices in various segments whether it is Blue, White and we do differential increases. And we have done that in the last one year twice already. And we have also increased the food and beverage related prices in our resorts.

So we do keep an eye on the inflationary aspects as well as our income. That is something that should not be a cause for worry at all. Because it is in our interest that we ensure that the right pricing happens for our product; we do not underprice our products because our product is a premium one and there is a demand for it.

Sumant Kumar: Would you please tell me what is the price increase YoY in Q2?

Kavinder Singh: We increased the price in Q1 and the effect of that would be what weighted average price increase will be about 4% across the SKUs. It is about 4% price increase we took across the seasons; we have these Purple seasons so we did a slightly higher price increase in White and Blue and slightly lower increase in the Purple and Red.

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Sumant Kumar: So, it was in Q1-FY17, right?

Kavinder Singh: We did it in the early Q1.

Sumant Kumar: What is the realization now?

Kavinder Singh: Our AURs are more or less in the same range as what we did last quarter around Rs 3.4 lakhs to Rs 3.5 lakhs.

Moderator: Thank you. We will take the next question from the line of Mr. Arjun Khanna from Kotak Mahindra Asset Management. Please go ahead.

Arjun Khanna: Just to carry forward from the earlier question. You mentioned your realization for this quarter was roughly 3.4%. So what was the corresponding realization in previous year, sir?

Kavinder Singh: Yeah, so this is the same, around 3.4% to 3.5% is what we are trending depending upon how much we sell in the various categories. It goes in that range.

Arjun Khanna: So, it is an impact of the mix even though we have taken a price increase, is it a mix impact?

Kavinder Singh: That is right.

Arjun Khanna: Secondly sir, if we look at the ASF, the numbers are actually up surprisingly given that we had mentioned that it is a mix of CPI and WPI so we did not expect such a jump; sequentially, we are up roughly 4.5% quarter-on-quarter. Could you help us understand this, sir?

Kavinder Singh: It is a combination of a few things. The combination of volume and the combination of price increase and we have taken a price increase of a little over 3%. So that contributes, firstly. And secondly, please understand that it is the base effect when the addition of 15,000 to 17,000 members that I had all adds to the base; all of them would now be eligible to holiday and they are eligible to holidays they have to pay their ASF. So all those incomes they can accrue.

Arjun Khanna: Sir, because I was just looking at this quarter's ending number and the previous quarter's ending number and the increase is roughly 8.75%. This number is much larger. We have over 20% jump. So if you look at our last year-ending number - as of this year we had 207,000 and we were 109,900 in second quarter of last year. But the jump in the number is actually much larger. How would we reconcile that, sir?

Vasant Krishnan: So you will have to reconcile that with three things. One as I told you is the base. The second is the inflation rate we spoke about both of them. The third is the de-recognition that happens whenever we cancel. So that also plays out in this. And that is another surrogate to tell you that

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how we are managing the quality and as the quality keeps improving that plays out in the cancelation and that consequentially also plays out in all our income lines.

Arjun Khanna: Sir, just for my understanding. ASF for our earlier member and the newer member is the same if you will see on a White irrespective of when he joins, right? Is that a fair understanding?

Vasant Krishnan: Yes. The difference in ASF is on the type of apartment – Studio, 1 BR or 2 BR

Arjun Khanna: So, I am talking for a player with same one bedroom, the rate should roughly be the same?

Vasant Krishnan: No, for a studio unit it will be one, one BR it will be more. And for a 2BR it will be even higher

Arjun Khanna: No, I am comparing for a White one bedroom whether he joins it two years back or five years back, will the ASF in this year be the same?

Vasant Krishnan: Yes, of course.

Arjun Khanna: So our price hikes have nothing to do with the ASF number?

Vasant Krishnan: No, it is not, because everybody will have to pay the increased ASF for this year.

Arjun Khanna: And our accounting for the ASF is when it is due it is divided into four parts or in the quarter in which you have accounted?

Vasant Krishnan: Exactly right.

Arjun Khanna: Sir, I have noted in terms of trend, the third quarter ASF is usually lower than the second quarter. What would be the reason for that, sir?

Vasant Krishnan: No again, like I told you multiple parts contribute to this. It is a function of base, it is a function of rate, it is a function of how much survive in the sense cancelations also play out. And an assessment of collectability also comes in here. So there are three or four moving parts that Give inputs to the ASF Revenue. So you cannot really come out and say whether this quarter is going to be high or low. All these are assessments that we do at the end of every quarter.

Arjun Khanna: Sir, because from FY12 to FY16 we are seeing that the third quarter is lower than the second quarter. Anyway I will take this offline. And lastly, in terms of additions what kind of growth do we expect because in terms of percentages it is easy look at but when you look at absolute number of members we are now talking of 16,000 to 17,000 which is a large number which entails building rooms also. So at what level do you think this number becomes very big where we need to concentrate on the absolute numbers rather than just percentages?

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Kavinder Singh: Yes, actually Arjun, the way to look at our growth story is like this. The kind of questions you are asking you obviously understand that each member that we get in is for 25 years and therefore there is a lifetime value to it and it is not about adding tens or thousands of members but it is about getting members and retaining them. And that is one key metric that we track internally and the second thing is that we need to be obviously be able to provide great experiences to the members when they holiday and therefore do we have sufficient inventory.

So, what we are doing constantly is building new inventory; as we speak we have four projects that are on. Three projects have broken the ground already. We have one project in Goa of about 250 rooms' new resort which is coming up. We have broken the ground in Astamudi where we are expanding currently. So we will have another 100 rooms coming up there in about a year-and-a-half's time. And then we have the construction that will start in Kandaghat which is another existing resort that will add another 140 units; it may happen very quickly in this quarter itself.

And then we have the one project that is a brand new greenfield project coming in Naldehra which is near Shimla and will add another 115 units hopefully in the last quarter of this year. So one of the ways to look at how we think about volumes and member additions is "are we building sufficient inventory in time?" So in some manner they are very good surrogate of the management's confidence as to what they think would be member additions. And we do not want to give guidance because we really believe that it is not the right way to think about the business.

And for us, our business is not just about selling membership, our business is about ensuring that we have sold we are giving the experience that we are promised and then we are paying true to the brand Club Mahindra over the 25-year life cycle. So that prevents us from thinking it like any other business where typically people who would be very happy with 5%, 10%, 15% growth. They are seeing that on a cumulative basis are we adding and are we adding sufficient numbers. And whether we most importantly servicing those members and we are adding obviously inventory add unique destinations which is what we are known for.

Moderator: Thank you. We have the next question from the line of Vikram Kashyap from Kedia Securities. Please go ahead.

Vikram Kashyap: Sir, I have two questions on macro level. Sir, we have targeted to be amongst top 5 vacation ownership companies in the world in terms of member base by 2019. I would like to know which are the top 5 companies and what is their member base? If you could guide us.

Kavinder Singh: So unfortunately this information is not available in the public domain. But what we know and it is something that we think is right. Wyndham is obviously number one. They have apparently a member base of about 900,000. So just tell you that the number one is at 900,000. And we are

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now at about 207,000 plus. If you add the Finland acquisition that we did we are at about 262,000. So clearly we are sometime away for becoming number one. That much we know. But deep down we would like to be number one. So that is the kind of gap. But, of course, the other big player in this business is Marriot. Then there is a player called Diamond Resorts. I really do not know their numbers but I know that they are bigger than us.

So you have Diamond Resorts, then you have Marriot. And then Starwood of course I think sold their business, the vacation ownership part of the business I think. And Hilton also has a vacation ownership business. But I think it is again sold. There are these four or five heavy hitters in the business. But I can tell you one good news that if you were to exclude the North American time share players, leaving North America, we are already the largest vacation ownership company in the world in terms of member base.

Vikram Kashyap: That is good to know. And, sir, in a recent interview of Mr. Nanda he has talked about something moving from rejuvenation to wellness. And with our focus on Spa, how are we planning to move ahead?

Kavinder Singh: See at the end of the day, when people come to holiday at our resorts, our belief is that we are a family-focused resort company. We would like every member of the family to be able to not only relax and rejuvenate but also in some manner get some immersive experiences which they would hopefully carry it for a significant period of time. So Spa is one part of the holiday activity that we have for adults. And that is something that we are driving. We believe there is an opportunity there. And also a lot of Indian families have not been exposed to Spa because it is not easy in a city to go into a Spa and get the experience because there is also a barrier in the minds of the people and also people are not able to think in terms of spare time.

So we believe there is an opportunity to grow the Spa business. We have a brand called Swasthya. We are seeing significant growth in that business. And we are also trying to create various activities that are around wellness in terms of Spa treatments, in terms of food and beverages or the menus that we have. So this is more around that. And obviously we do have in some of our resorts meditation space where people can go and meditate, relax and rejuvenate. So, the whole concept of holistic wellbeing of the mind and body is something that we are driving. And this ensures that not only we do this for the adults we are trying to see how children can also get away from the electronic gadgets and do things beyond.

So we are also trying to do a lot of stuff around the creativity bit where the child not only gets entertained but he also gets educated; therefore, we use the terminology called Edutainment which is what we want to do for children. So it is about mind and body and getting a whole sense of wellbeing rather than a treatment where you are going on a retreat and you have to keep quiet or where you have to eat a very specific type of food but we are not in that space.

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Vikram Kashyap: And sir, how did our subsidiaries perform in the first half in HCR?

Vasant Krishnan: So we will get back to you with greater details in the times to come. But I have always been maintaining that it is a long-term investment and as we know Europe is facing a lot of turbulence, HCR not being an exception. The Russian situation continues to causes some concern. But there are some green shoots that we have to wait and watch to see how they ultimately pan out. Cost rationalization measures have been introduced and they will take some time to play out. And we remain hopeful that, in the next two or three quarters, some of the measures that we have been taking in Finland will start to yield the outcome that we desire.

Moderator: Thank you. We have a follow-up question from the line of Aditya Bagul from Axis Capital. Please go ahead.

Aditya Bagul: Sir, couple of questions from my end. Sir, apart from a mix deterioration do you think that there is any other line item which is playing into the low VO income growth?

Vasant Krishnan: No, I do not know why you say there is a mix deterioration. I just said that our range of AUR would remain the same. Our VO income again there are a number of moving parts. The rate at which the customer comes in, the quantum of cancellations, the number of upgrades that we do. All of them play out when you compute the VO income. So there has been no mix deterioration. The mix and the AURs have been in the same range over several quarters now. And we have taken the price hike increase and that has been well received in the market

Aditya Bagul: And would it be fair to assume that the quantum of cancellations have also remained in the historical bands that exist?

Vasant Krishnan: In this particular quarter, it was slightly lower than what we had earlier. But again, cancelation is a function not just of the number of units, it also depends upon the value of the units that we cancelled. So in terms of value we are more or less there. But again like I said this is an assessment that we make every quarter and as of now we are not seeing anything that has causing any great deviation from the standards that we are used to.

Aditya Bagul: Just some bookkeeping question, sir. Just wanted to know the number of rooms that you plan to add at Kandaghat and Naldehra?

Kavinder Singh: Naldehra is 130 units and Kandaghat will be somewhere around 140 units.

Moderator: Thank you. That was the last question.

Vasant Krishnan: Thank you very much to all of you for joining the call. I would like to make a concluding comment. This is on the balance sheet. I am not sure how many of you had the time to look at

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the numbers. I know that this was uploaded on the website just a few minutes before the call and you may not have had the time to go through in detail.

So I just want to take the opportunity to highlight a particular item in the balance sheet which is the other equity at Rs. 622 crores. That has undergone an adjustment which is an IND-AS adjustment pre-dominantly on account of an expected credit loss entry.

Now just to make you all understand as to what is an expected credit loss. You have to go back to our revenue recognition and you must be aware that whenever a member is cancelled, the receivables and the revenues are de-recognized at the time of cancellation. We also do an assessment of receivables every quarter and if we believe that there are installments that doubtful of recovery then the revenues and receivables are de-recognized even though that member may not have been physically cancelled in that quarter.

This is the position under Indian accounting standards or I-GAAP.

Now under IFRS that position gets changed and they have introduced a concept which is called the expected credit loss accounting. Now under I-GAAP what happens is that if an event has happened and if you make an assessment that a particular customer is unlikely to honor his commitment to pay his installments, then you need to make suitable adjustments to revenue and receivables.

In the expected credit loss model, you are expected to forecast (whether or not the customer receivable is due to you today), about the likelihood of that member defaulting in his installment payments. For example, a customer might have just come in and might be say three months old but still you are expected to forecast based on historical data trends or whatever forecasting methodology you want to adopt as to the likelihood of that customer defaulting in his payments.

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Now obviously we cannot do it on a customer-by-customer basis so we do is what is called the pooling approach. So from the total database of members, we determine a percentage of members that is possibly likely to go delinquent over a period of time and this is an expectation of a credit loss over their life-time because we have followed the the expected “life time credit loss” methodology.

So this purely what I call a timing effect, what would have been accounted over a period of time as and when dues become doubtful, is now being accounted based on a forecast of likely credit loss in the future

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What would have happened over a period of time as and when that event happens, the standard now requires you to forecast everything and provide for it now. So that is the timing issue more than anything else.

And the standard recognizes that whenever you have to make a change, what is called a transition change, it will have to be debited to reserves and that is exactly what we have done. So there is an impact to reserve and an impact to receivables.

If you compare the I-GAAP position as of 31 March 2016 from the published accounts you would see a figure of Rs. 691 crores and the equivalent figure in the Ind AS regime is Rs. 610 crores. That means a reduction of around Rs. 81 crores.

Add the profit for the two quarters of around Rs. 63 crores and you also have to deduct under the dividend that is paid. As you aware in the Indian accounting standards, the dividend entry is routed through the P&L. Under Ind AS, you have to adjust the reserve as and when the dividend is paid out. So that is what is what we have done.

So from the Ind As opening equity of around Rs. 610 crores as at April 2016, you have to add the profit, reduce the dividend and come to the closing equity of Rs. 622 crores, which is what you see in the balance sheet that is published and uploaded.

So that is the statement I wanted to make on ECL and the adjustments that we have done to the balance sheet consequent to the transition that the company has made in the accounting from I-GAAP to IND-AS.

Thank you very much to all of you for joining the call. If there are any further questions on ECL, we will be happy to answer all of them. Because I understand this is new and you have questions / clarifications. Wish you all a Very Happy Diwali. Thank you very much.

Moderator: Thank you very much. With this we conclude the conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.

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