

Hotel Case Study

About the Case

Abriel works in a consulting organization XYZ Consulting based out of Gurgaon, India. XYZ Consulting has been approached by a Germany based client who intends to invest in a green-field hotel venture in India. He has done a preliminary operational and market feasibility study and wants an integrated financial model with projections for 6 operational years.

Abriel is the project lead on this assignment and he quickly sets up the first meeting with the client to understand the project requirements in great details. During the project kick off meeting, Abriel holds a constructive discussion with the client and his secretary has made the following minutes of meeting:

- **Rooms:** The proposed investment (“hotel”) will have 200 rooms with the following mix:
 - a) Standard rooms – 50%
 - b) Deluxe rooms – 30%
 - c) Executive Suites – 20%

- **Commencement of Project:** The construction of the hotel would start in Jan 2022 and would take 2 years to complete. As such, the hotel will start its operations in Jan 2024.

- **Capital Expenditure:** The initial estimate on capital expenditure is as under:
 - a) Land requirement – 6,000 sqm to be acquired @ Rs.50,000 per sqm
 - b) Construction cost – Based on discussion with technical consultants, the total construction cost is estimated to be Rs.750 lakh
 - c) Furniture and fixture – Rs.250 lakh

- **Depreciation:** The hotel building would be depreciated over an economic useful life of 30 years, while furniture and fixture would be depreciated over 10-year period.

• **Project Financing:** The client expects to finance the project as under:

- a) Debt to Equity mix – 40%:60%
- b) Debt would be raised from an Indian Bank at an interest rate of 12% p.a. payable annually; however, there will no interest payment in first two years
- c) Entire debt would be raised in Jan 2022 and would be repaid in 10 equal annual installments starting from Dec 2025
- d) There will be no dividend payment till Dec 2026; however, post that the net profit would be distributed to the shareholder at 25% each year

• **Room Rent:** Based on the market study and the prevailing rates, the client has decided to charge the following average daily room rent (ADR) for its hotel:

- a) Standard rooms – Rs.4,000 per room per day
- b) Deluxe rooms – Rs.6,500 per room per day
- c) Executive Suites – Rs.8,500 per room per day
- d) The above room rates are applicable for the first year of operation and would be increased @ 10% each year for next three years and 5% thereafter

• **Occupancy:** The client's hotel is expected to enjoy the following average occupancy:

- a) Standard rooms – 45%
- b) Deluxe rooms – 35%
- c) Executive Suites – 40%
- d) The above occupancy rates are applicable for first year of operation and are expected to increase by 5% points each year till it reaches 60% for all categories. The occupancy rates are expected to remain stable thereafter.

• **Events:** The hotel would also have a banquet hall. Based on market research, the client expects the following:

- a) Client expects to host approximately 5 events in each month
- b) In line with the fees being charged by other hotels, the client also proposes to charge Rs.5 Lakh for each event
- c) The amount being charged would be increased at 10% each year
- d) The number of events is expected to remain unchanged.

- **Other Revenue:** Other revenue assumptions are as under:

- a) Food and beverage revenue – Approximately 12% of room revenue

- b) Misc. other revenue – Approximately 8% of room revenue

- **Operating Expenses:** The client has done a benchmarking of hotel players and summarizes the operating expenses as under:

- a) Room expenses – 18% of Room revenue

- b) Banquet hall expenses – 40% of Banquet Hall Revenue

- c) F&B expenses – 35% of F&B revenue

- d) Other expenses – 40% of Other revenue

- e) General & administration expenses – 10% of Total revenue

- f) Utility expenses – 5% of Total revenue

- g) Sales & Marketing expenses – 3.5% of Total revenue

- h) Repair & maintenance expenses – 3% of Total revenue

- i) Base management fees – 9% of Total revenue

- **Tax Rate:** The average tax rate may be taken as 25% flat

- Client has also suggested that Abriel may take other assumptions required for building the final model and make a note of them.

- Abriel understands that the task is not small and he would have to burn midnight oil to consummate the project in the given deadline. He needs to provide regular updates to the client on the project progress. Thus, he sets the following milestones for furnishing the draft workings to the client:

- a) Milestone 1 – Set the key assumptions in place along with a broad structure of Income Statement and Balance Sheet.

- b) Milestone 2 – Prepare detailed schedules for revenue drivers, cost drivers, financing structure and depreciation along with the completed projected financial statements.

Note – This is a hypothetical situation, and this model would show how I as a financial modeler would build a financial model for a hotel industry firm.