汉庭连锁酒店
HANTING INNS & HOTELS

Date: **10 May 2010**

Title: **2010 First Quarter Earnings Conference Call**

Time: **9.00 pm ET**

Corporate Participants:
Matthew Zhang, CEO
Jenny Zhang, CFO
Ida Yu, IR Manager

Conference Call Participants:
Adam Krejcik – Roth Capital Partners, Analyst
Just Kwok – Goldman Sachs, Analyst
Lin He – Morgan Stanley, Analyst
Chunming Zhao - SIG
David Freddi – RME Capital, Analyst
Paul Keung – Oppenheimer & Co., Analyst

Transcript

Ida Yu:

Hello everyone and welcome to our First quarter 2010 Earnings Conference Call. With us today is Matthew Zhang, our Chief Executive Officer, and Jenny Zhang, our Chief Financial Officer. Matthew will provide business and operation overview of our company and Jenny will be further discussing our financial performance for the past quarter. After their prepared remarks Matthew and Jenny will be available to answer your questions. Before we continue, please note that discussion today will include forward looking statements made under the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995.

Forward looking statements involve insurance risks and uncertainty. As such, our results may be materially different from the views expressed today. A number of potential risks and uncertainties are outlined in our public filings with the SEC. China Lodging Group does not undertake any obligation to update any forward looking statements except as required under applicable law.

On the call today, we will also mention adjusted financial measures during the discussion on performance. The calculation of those measures to comparable GAAP information can be found in the earnings release that was distributed earlier today.

Please note that the numbers discussed in this conference call is in RMB terms. As a reminder, this conference call is being recorded. In addition, the web cast of this conference call will be available on China Lodging Group's industrial relations website at ii.htinns.com. I will now turn the call over to our CEO, Matthew.

Matthew Zhang:

Thank you for joining us today. This is our first conference call as a public company following a successful IPO on Nasdaq Stock Exchange in March. For the benefit of those of you who are not very familiar with our company I would like to provide a brief introduction.

China Lodging Group, also known as HanTing, is a leading economy hotel operator in China. We offer three hotel products with distinct price points namely HanTing Seasons Hotel, HanTing Express Hotel and HanTing Hi Inn. Our multi-product strategy covers a wide section of customers in this sector. As of March 31, 2010 we have a network of 282 hotels in operation or 33,650 rooms consisting of 178 leased and operated hotels and 104 franchised and managed hotels. Our geographic coverage expanded to 47.

HanTing's success is based upon best location, superior product and services as well as our solid execution. The majority of our hotels are located in China's economically more developed cities. We typically select central or highly accessible locations for hotels which give our customers easy access to business, shopping and entertainment facilities. The prime location of our hotels and the high quality products and services have enabled us to establish a premium brand which attracted an increasing number of quality frequent travellers to experience our hotels and join HanTing Club, our loyalty program.

As of March 31, 2010, HanTing Club had more than 1.75 million individual members. Our solid execution is well supported by our advanced proprietary IT system. The system is a web-based enterprise level system which generates real time data to support centralised management to maximise yield and to enhance consistent service. As a result, HanTing has been growing rapidly and profitably.

During the first quarter of 2010 we opened 46 net new hotels, including five net leased-and-operated hotels and 41 net franchised-and-managed hotels. This brought our total number of hotels in operation to 282 in 47 cities compared with 236 hotels in 39 cities at the end of last year. As of March 31, 2010, we had a strong pipeline of 144 hotels under development consisting 32 leased-and-operated hotels and 112 franchised-and-managed hotels.

We are pleased with the strong momentum in the beginning of 2010 as both top line and bottom line improved year-over-year during the quarter. Net revenue increased 34.5% year-over-year to RMB340.9 million. Net income attributable to the company was RMB12.4 million compared with a net loss of RMB27.5 million a year ago, achieving a profit in the first quarter, typically a low season for hotel industry in China, demonstrated our strength in planning and execution.

Let’s look at the key operational metrics. In the first quarter of 2010 occupancy rate was improved to 93% from 85% in the same quarter last year compared with 95% in the previous quarter. ADR was improved to RMB173 from RMB169 in the same quarter last year compared with RMB177 in the previous quarter. RevPAR was improved to RMB161 from RMB144 in the same quarter last year compared with RMB168 in the previous quarter.

The year-over-year increase was driven by both higher occupancy rate and higher ADR. The sequential decrease was mainly due to seasonality as the first quarter is typically the lowest season for the hotel industry in China because demand is dramatically decreased during and around the Chinese New Year.

The same hotel RevPAR for at least 18 months in operation was RMB168 for this quarter compared with RMB150 for the same quarter last year. The improvement was caused by both higher occupancy rates and higher ADR contributed by the economy recovery and our brand strengthened.

Now I would like to turn the call over to Jenny Zhang, our CFO, to walk us through the financials in more detail.

Jenny Zhang:

Thank you Matthew. Hello everyone. I'm glad to report to you the financial results of the first quarter. The revenues for the quarter increased 34.3% year-over-year to RMB360.7 million primarily as a result of our enlarged hotel network and higher RevPAR. Comparing to the fourth quarter of 2009, the total revenue decreased 2.6% due to seasonality. As mentioned by Matthew earlier, the first quarter is typically the low season for our hotel industry in China.

Total revenue for leased-and-operated hotels for the first quarter of 2010 were RMB339.2 million representing a 29.2% increase year-over-year as both the number of leased-and-operated hotels and the revenue for leased and operated hotels increased.

As of March 31, 2010, we had 178 leased-and-operated hotels in operation compared with 151 a year ago. Total revenue from franchised-and-managed hotels for the first quarter of 2010 were RMB21.6 million representing a 258.1% increase year-over-year mainly due to the enlarged space of franchised-and-managed hotels. As of March 31, 2010, we had 104 franchised-and-managed hotels in operation compared with 30 a year ago.

Net revenue for the quarter were RMB340.9 million representing an increase of 34.5% year-over-year and a decrease of 2.7% sequentially due to seasonality. Total operating costs and expenses for the quarter of 2010 were RMB323.7 million compared with RMB285.3 million in the same quarter of 2009 and RMB317.1 million in the previous quarter.

Also operating costs and expenses including share-based compensation incentives for the quarter were RMB320.3 million representing a 12.8% increase year-over-year mainly due to expansion of hotel network and a 2.1% increase sequentially mainly due to seasonal increase of utility costs. Major components of operating costs and expenses are described and discussed in more detail as follows.

First of all hotel operating costs for the first quarter were RMB272.2 million, representing 79.8% of net revenue. Hotel operating costs excluding share-based compensation incentives represented 79.7% of net revenue compared with 95.3% for the same quarter in 2009 and 76.3% in the previous quarter. The decrease in hotel operating costs as a percentage of net revenue, year-over-year was primarily due to higher revenue per hotel. The sequential increase was primarily due to seasonal increase of utility costs.

Selling and market expenses for the first quarter were RMB14.5 million. Selling and market expenses excluding share-based compensation incentives was RMB14.3 million representing 4.2% of net revenue compared with 3.5% for the same quarter in 2009 and 4% in the previous quarter. Selling and marketing expenses fluctuated from quarter to quarter mainly due to timing of marketing programs and the changes relating to customer loyalty programs.

General and administrative expenses for the first quarter of 2010 were RMB25.8 million. General and administrative expenses excluding share-based compensation incentives were RMB23 million or 6.7% of net revenue compared with 7.4% of net revenue in the same period of 2009 and 7.2% in the previous quarter.

Pre-opening expenses for the first quarter of 2010 were RMB11.2 million, a decrease of 25% year-over-year and increase of 47.1% sequentially. The fluctuation of pre-opening expenses was mainly driven by the number of leased and operated hotels under construction.

Income from operation for the quarter was RMB17.2 million. Excluding share-based compensation incentives adjusted income from operation was RMB20.6 million. This compares to adjusted loss from operations of RMB30.5 million in the same quarter of 2009 and adjusted income from operations of RMB36.4 million in the previous quarter.

Net income attributable to the company for the quarter was RMB12.4 million excluding share-based compensation incentives adjusted net income attributable to the company for the first quarter of 2010 was RMB15.9 million. This compares to adjusted net loss attributable to the company of RMB26.3 million in the same quarter of 2009 and adjusted net income attributable to the company of RMB23.1 million in the previous quarter. The year-over-year improvements on profit mainly attributable to the expansion of our network, a more matured leased and operated hotel portfolio and improved RevPAR as a result of strengthening economy and our brand. The sequential decrease in profits was mainly driven by seasonality.

For the first quarter of 2010, the net earnings per ADS was RMB0.26 and diluted net earnings per ADS was RMB0.25. Excluding share-based compensation expenses, the adjusted basic net earnings per ADS was RMB0.33, while adjusted diluted net earnings per ADS was RMB0.32.

EBITDA for the first quarter of 2010 was RMB54.9 million, compared with RMB2.3 million in the same quarter of 2009 and RMB69.3 million in the previous quarter. EBITDA from operating hotels was RMB66.1 million, an increase of 282.3% from the same quarter of 2009 but a decrease of 14.1% sequentially.

Net operating cash flow for the first quarter of 2010 was RMB87.2 million. Cash spent on the purchase of property and equipment which is part of investing cash flow was RMB65 million.

As of March 31, 2010 we had cash and cash equivalent of RMB258.4 million. In March HanTing completed the IPO and a private placement to Ctrip raising approximately $140 million in total after underwriting fees and expenses. The proceeds from the IPO and the private placement were received in April and thus not included in the cash balance as of March 31, 2010.

We are encouraged with our progress in the first quarter of 2010. Thanks to China's strengthening economy, the demand for affordable accommodation with quality continues to grow. We are on track in executing our hotel network expansion plan. In 2010 we plan to add 180 to 200 hotels with 60 to 70 leased and operated hotels and 120 to 230 franchised and managed hotels. We expect to achieve net revenues in the range of RMB395 million to RMB415 million in the second quarter of 2010. We expect our full year net revenue to grow 33% to 35% from 2009.

Please be aware that the above forecast reflects the company's current and preliminary view which is subject to change. With that, we will now open the call to any questions that you may have.

Q&A

Adam Krejcik: Hi, thanks for taking my question. I was wondering if you could disclose what kind of impact the Shanghai Expo is having so far on your portfolio of hotels? I guess, a couple of follow-up questions to that, if you could disclose how many leased and operated hotels you currently operate in Shanghai. And I know the Expo has just begun but what kind of occupancy have you seen in the first 10 days and what kind of impact is it having on the ADR and in for those hotels in Shanghai, thanks.

Matthew Zhang: We see the Shanghai Expo will have positive impact to our hotel operation's performance in both ADR and occupancy in Shanghai as well as adjacent cities. Because it happened only a few days, it's too early to have an accurate estimation in numbers at this point. The hotels in Shanghai, we have accounts for 23% of total number of rooms of our network.

Adam Krejcik: In terms of your second quarter guidance then, I think it's about 25% to 32% growth year-on-year. Does that include any kind of benefit from higher ADR and occupancy driven by the Expo or is that essentially all organic growth?

Matthew Zhang: We embedded a little of that positive impact to our outlook for this year's growth, yes. But, again, it's very difficult to accurately forecast the exact numbers in both ADR and occupancy but we are very positive that the Shanghai Expo will have a positive impact to the performance of our business.

Adam Krejcik: Great, and then if I could ask just another. Any kind of detail you could provide in terms of how many leased and operated hotels and franchise managed hotels you plan to open in second quarter? I know you've disclosed the full year numbers but any type of range you could provide for the second quarter would be helpful.

Matthew Zhang: For the second quarter, we plan to open eight to 10 leased and operated hotels and 32 to 38 franchised and managed hotels.

Chunming Zhao: Thank you for taking my questions. I have two quick questions here. First, just on Ctrip's investment in HanTing, can you give us some idea what you can get from that investment in addition to the cash? Is there any synergy there which you would look for?

Jenny Zhang: Thank you for your question. We have long respected Ctrip as a leading player in the travel industry so their investment into our business, I think, first of all will help us to gain more insight into the industry and thus provide useful guidance when we make certain strategic decisions.

Secondly, as a well respected consumer brand, especially in the travelling domain, by associating HanTing's brand with Ctrip's brand I think it's also great for our brand equity. At the same time, the two companies are taking certain steps to collaborate so as to use their manual work in the ordering and the booking process decreasing the cost of both sides. So those are some values we think we can get beyond the cash receipts.

Chunming Zhao: Just a follow-up for that, some of your competitors actually have ceased to use the agencies as a channel. Can I ask what percentage of your customers is coming from the agencies that you work with including Ctrip?

Jenny Zhang: Currently 5% of our room nights were sold through agents.

Chunming Zhao: Very good. The second question I have is, if we look at your annual strategy of increase in the hotels it seems like the growth on the franchised and managed hotels, the number there is much faster or bigger than the leased and operated hotel and you guided the annual revenue growth. Should we expect the operating profit to grow faster than the top line given that your expansion strategy is mostly, or let's say, bigger on the franchised and managed hotel?

Jenny Zhang: Yes, our franchised revenue does lead to a higher margin contribution.

Justin Kwok: Hi, good morning Jenny and Matthew. Thanks for taking my question. I have a few questions. Number one is regarding the opening target because in your results you mentioned that there are 32 leased and operated hotels under development at the end of the first quarter. I just wonder what would the number be today at the middle of May, because I believe that the conversion process would take more than six months so we just want to get a sense on, in terms of the opening target as to how many of them have been secured right now, thanks.

Matthew Zhang: I think, with the forecast of the new hotels in 2010, 180 to 200 new hotels consisting 60 to 70 leased and operated. If you look at our current pipeline, we continue to be strong, of total 144. Also at this point, we are very on track in terms of contracting the new lease deals and we're very confident we can achieve 60 to 70 leased and operated hotels within this year.

Justin Kwok: Thank you, and the other question is that I saw that your franchised and managed hotel portfolios occupancy picked up quite a bit compared to first quarter last year. Even though you had a bit more - a new opening in the last two quarters. Do you want to share with us your ramp-up pace for these new hotels? Is it ramping up faster than your previous discussion or guidance? Thanks.

Jenny Zhang: Basically the economy has improved this year so that helped us to more and more quickly ramp up with the new hotels. We still expect the hotels ramp-up period to be around five to six months.

Justin Kwok: My last question is on the cost trend to now and the first quarter of this year on the two months in the same quarter, how do you see the cost trend moving forward because I think a lot of people are worrying on the pick-up and inflation in China, thanks.

Jenny Zhang: We do see certain costs - the price is increasing such as the minimum salary increase will have certain impacts on our labour costs and the utility price is also increasing in China. Nevertheless, I think HanTing is well positioned in managing those costs. First of all we have one of the lowest in staff to hotel room ratio in the industry so we are well positioned to absorb and manage the labour cost increase. We are also making a lot of effort in reducing the utility usage. For example, adopting a solar energy approach in certain hotels. So with those efforts we are confident that we can manage those costs within a comfortable level.

At the same time, the inflation will enable us to increase our ADR at the same time and we expect the margin to remain stable as the top line increase and the cost line increase will be in similar case in general.

Lin He: Hi Matthew and Jenny. Good morning. First of all, congratulations on the good quarter. I have a couple of questions. Firstly, when I look at the ADR of your franchise hotels in the first quarter, they posted a slight decrease on the year-over-year basis so could you please give some more colour on that and would you - from your perspective, do you think that trend will continue going forward?

Matthew Zhang: The main reason for the decrease of ADR of the franchised and managed hotels because, as you know, that we had a lot of new hotels in our portfolio. So the performance will improve after the ramping-up period. Going forward, there will be a small dilution of franchised and managed hotels because their location is not as good as leased and operated hotels but this will also be offset by the overall performance improvement of the whole group due to the high percentage of mature hotels and the same hotel improvement in terms of our ADR and RevPAR. So we foresee the blended RevPAR will be slightly increased in the long run.

Jenny Zhang: Just allow me to add one more point to Matthew's comments. At the end of this quarter we have 104 franchised and managed hotels whereas it was 30 a year ago. So the geographic location of the portfolio has significantly changed. That's one of the main drivers that impacts the ADR and, at the same time, if you look at the like-for-like performance for hotels opened for at least 18 months during the coming quarter we have noticed that the franchised hotel ADR, which have been in operation for 18 months actually improved from last year to this year significantly.

Lin He: Thank you. My second question is regarding the cost side. When I was looking at your hotel operating costs I found that the hotel operating costs posted 13% year-over-year growth in this quarter. This is lower than the room supply growth of leased and operated hotels, so which indicates that you have achieved some operating leverage or cost saving. So could you please let us know in which cost items because we can't see the breakdown here. In which cost items have you seen the significant operating leverage or cost saving? Thank you.

Jenny Zhang: We have small cost savings here and there but the main contributor actually is more on the top line than on the cost items. First of all, the franchised and managed hotel revenue increased significantly relative to last year and that revenue has a very small number of costs associated with it. Secondly, our RevPAR has increased 12% this quarter relative to a year ago. So those two are the main drivers after cost percentage decrease.

Lin He: Thank you, and my last question is regarding the tax rate. Could you please guide us what kind of tax rate should we model in the following quarters - income tax rate?

Jenny Zhang: We are expecting a standard 25% in the next few quarters for the moment.

David Freddi: Good morning. Thanks for taking my questions. I see that in the full year guidance you have given, you seem to be discounting the same ADRs that you have realised in 2008 but the difference this year compared to 2008 is that your off season fee is very higher. I was just wondering if the ADR has scope to be even higher as time goes on, higher than just going up in line with inflation?

Jenny Zhang: Let me take that question. By comparing the ADR of this quarter directly with 2008 wouldn't be an apple-to-apple comparison because the portfolio has expanded so much that the location of the hotels we now have is different from those in 2008. One and a half years ago in 2008 our hotels were even more concentrated in tier 1 cities. So the ADR we achieved in tier 1 this year actually indicates the ADR has significantly firstly recovered from 2009 and also improved from a 2008 level.

David Freddi: So you anticipate then the ADR could exceed the inflation rate or are you just estimating it to go up in line with it?

Jenny Zhang: Currently we are expecting the ADR to be more or less in line with the inflation.

David Freddi: Okay, excellent. Just another question. I understand that the guidance for franchised and managed hotels is to open 125 in this year. If I add the 112 under development to the 41 that you have opened in quarter 1 that gets me to 153. Could you just help me understand this difference?

Matthew Zhang: I think that our pipeline today are consisting of contracted and also under developed so not all of the pipelines will open this year. Some of them will open next year so if you add today's number plus the pipeline that will be greater than the outlook we have.

David Freddi: I've understood and, finally, could you just remind us what shares outstanding are?

Jenny Zhang: Around 241 million ordinary shares outstanding at this moment.

Paul Keung: The pipeline size or the development pipeline for the top chains right now, it looks like there may be one exception or increasing the growth top line as much as 50% in some places, double what they did last year. So from the competitive standpoint, are you seeing any impact it has as you negotiate for these big contracts in your pipeline? In other words, are you seeing contract terms become shorter? What's happening to the upfront fees, the royalty fees and, of course, the rental rates?

Matthew Zhang: We see quite a stable term as before in terms of lease terms period times and stuff like that and step of increase and everything. Also, that there are sufficient property supplies in the market. Each of the company operator has different site selection strategy due to the brand positioning and stuff like that. So we are pretty on track, let's put it this way, to secure the same quality level of the lease as before.

Paul Keung: Great, and the other question is, are you seeing for your partners that are franchising from you, I'm curious if they are able to get, from a lending standpoint and from a macro standpoint, what's the lending environment like or the capital access environment like for your franchise partners?

Jenny Zhang: Currently, we haven't seen many franchisees coming to us and raising concerns on their own fund source at this moment. In general I think the cash supply in the market is still fairly abundant. At the same time, we have certain banks who are favourable to our franchisees and they offer some standby loans. It interests me, you know, we haven't seen any taking those loans. I think the franchisees are much self sufficient in their own funding.

Paul Keung: The last question is regarding - I think you mentioned your pipeline expectations - your growth expectations for a full year, you mentioned earlier in the question, for the quarter. What is the capital expenditures and pre-opening expenses, estimate roughly, for those figures?

Jenny Zhang: Sorry, could you just say it again?

Paul Keung: What's your estimate for pre-opening expenses and CapEx in the second quarter at full year 2010?

Jenny Zhang: Currently, we don't provide guidance at that level. Generally the pre-opening expenses, it will be in proportion to the number of leased and operated hotels we open and the CapEx is similar.

Adam Krejcik: Thanks for taking my follow-up. Just really quickly, any way you can talk about what the ADR occupancy and RevPAR was for April? If you don't want to disclose the specific numbers, perhaps how it trended relative to first quarter 2010?

Matthew Zhang: I think it's too early to quote the exact number of April performance but in general terms, April is better than first quarter for sure and also is better than the same period of last year.

Adam Krejcik: Got it, and then just one more if I can, Matthew? Can you talk about how you look at your expansion? Do you view - I get tier 1 cities as fairly saturated still or do you think there's still more opportunity to grow in tier 1 cities and then what does your guidance take into account in terms of tier 2 and tier 3 cities this year? Thanks a lot.

Matthew Zhang: We feel the abundant property supplies being across all tiers. As you know, we are concentrated in the past in the economically more developed cities and especially tier 1 cities, we are very experienced and has a very good social network of the tier 1 city and we continue will seek a favourable lease in these tiers. We do not see harder than before to find these leases in terms of number of lease we put there. But this year, as you know, that we're expanding two lower tier cities because these cities are getting better and more ready for our kind of business. So we'll take a more balanced approach to expand our network across all the tiers but, again, we'll continue to focus on the higher tier cities, and we do not see difficulties in that.

Paul Keung: I think you indicated that 68% of your room nights come from your numbers last year, what was that percent first quarter and do you think that percent will actually increase due to balance this year?

Matthew Zhang: I think that the first quarter will - 70% room nights sold were through our individual and corporate members and we'll see that number around 70% going forward.

David Freddi: Hello again. Just wondering if you could give us a guidance on your EBIT margin. I understand that you're going to add more leased and operating hotels than your quarterly add rate recently. So just wondering if that would have meant a similar EBIT margin in 2010 to what you had last year or perhaps a bit better?

Jenny Zhang: We expect the EBIT margin this year to be improved from last year. There are a few factors that are impacting the EBIT margin. First of all, the percentage of franchised and managed hotel revenue that's going to increase this year. Secondly, we expect the price this year as well as RevPAR to increase this year, which on top of that will actually add a little bit more to the overall revenue generated from hotels in Shanghai and the nearby area.

We are also expecting certain offsetting factors such as the pre-opening expenses is likely to be higher than last year as we are opening more leased and operated hotels this year. Combining all those drivers together we do believe the next profit margin as well as the EBIT margin will improve this year.

Again, thank you all for your support of HanTing. We look forward to reporting more positive developments in our business for many quarters to come. I will represent HanTing to present on Piper Jaffray China Growth Conference on May 13 and the Oppenheimer China Dragon Call Conference on May 18 and 19. So if you are interested in meeting at those conferences in New York please feel free to contact organisers, so good-bye everyone.

Matthew Zhang: Thank you and good-bye.

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