RATING REPORT

Avari Hotels (Pvt.) Limited

REPORT DATE:
October 2, 2018

RATING ANALYSTS:
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RATING DETAILS	
	Initial Rating
Rating Category	**Long-term**
Instrument Rating	AA
Rating Outlook	Stable
Rating Date	*September 17, 2018*

COMPANY INFORMATION	
Incorporated in 1968	**External auditors:** Kreston Hyder Bhimji & Co.
Private Limited Company	**Chairman of the Board:** Mr. Byram Dinshaw Avari
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Byram Dinshaw Avari
Beach Luxury Hotel Limited – 85%	
Avari International Hotels – 12%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May 2016)
http://www.jcrvis.com.pk/kc-meth.aspx

Avari Hotels (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Avari Hotels (Pvt.) Limited (AHL) was incorporated as a private limited company in 1968. Later, AHL was converted into a public limited and then re-converted into a private limited entity in 2016. Holding company of AHL is Beach Luxury Holdings (Private) Limited. The company is engaged in provision of hospitality services. Shareholding of AHL is primarily vested with Avari Family.

RATING RATIONALE

Avari Hotels (Private) Limited (AHL) plans to acquire a Privately Placed Term Finance Certificate (PPTFC) amounting to Rs. 4.6b for partially expanding its properties while the remaining proportion will be utilized for retiring existing debt on the books. This loan will be present on the books of AHL while it will be completely serviced by one of AHL's largest existing tenant, Unilever Pakistan Limited (Unilever). With an asset size of Rs. 35.8b, Unilever is known as one of the largest FMCG operating in Pakistan for a number of decades. Total equity of the company was Rs. 3.0b as at December 31, 2017. Its last reported turnover and net profit amounted to Rs. 86.3b and Rs. 13.2b, respectively. Unilever's parent company, Unilever PLC, carries an international long term rating of 'A+' by Fitch. Unilever has been a tenant of AHL for 35 years.

Table 1: Key Figures of Unilever

BALANCE SHEET *(Rs, in b)*	**Dec-17**	**Dec-16**
Property, Plant & Equipment	14.8	12.4
Cash & Bank Balances	8.2	13.1
Total Assets	35.8	35.9
Total Debt *(*incl. current maturity)*	-	-
Total Equity	3.0	4.7

INCOME STATEMENT *(Rs, in b)*	**Dec-17**	**Dec-16**
Net Sales	86.3	77.2
Gross Profit	39.7	35.3
Operating Profit	17.9	14.5
Profit After Tax	13.2	10.2

Features of the Privately Placed Term Finance Certificate

The facility, agreed upon by AHL and Unilever, is structured as an advance discounting of the lease rental agreement for nine years. The security structure is tripartite [lenders, AHL and Unilever] with Unilever giving an undertaking to pay principal and markup payment on the PPTFC against rent payable in lieu of advance rent they would have ordinarily paid. The facility is additionally secured by a charge on assets of AHL.

Core features of this instrument are:

- Tenor of the facility is 8 years and 10 months.
- Markup will be payable annually calculated on a 365-day year basis on the outstanding principal amount. Moreover, principal repayment will be made in 9 installments. Both markup and principal payments will be made on July 1 of every year, starting 2019.
- All markup and principal payments will be made directly by Unilever into an account with the agent bank; this account will be under lien with irrevocable instructions to retire debt as payments become due.
- In accordance with the lease deed between AHL and Unilever, at the end of 10 years, the lease will be renewed automatically unless Unilever gives a minimum of 24 months' notice before expiry of the existing term. Additionally, in case Unilever operations are sold or transferred, the

new purchaser / transferee will continue the same obligations as defined in the original lease deed along with the existing conditions.

- In case Unilever plans to sub lease a portion of its leased property, there will be no effect on this financing arrangement and all covenants defined will continue to remain Unilever's responsibility till the expiry of the lease agreement.
- Moreover, irrevocable instructions will be issued by Unilever to their bank to ensure payment of assigned advance rent and applicable cost of financing on every due date to the customer's debt service account held under lien with the agent bank.
- In accordance with the undertaking, Unilever will make its due payments on May 16th of every year, however the principal and mark up payments have the due date as July 1st to account for any delay which may occur. In order to reconcile this difference in dates AHL will make mandatory prepayment of the principal within 3 days of receipt of payment received from Unilever, as it is being deposited in the collection account with agent bank in order to give comfort to the lenders.
- The agent bank will also maintain a profit bearing deposit amounting Rs. 914m for servicing of markup payments.
- Principal payments are in correspondence with the agreed upon rental rate, which will be escalated by 10% every year.
- Subject to Unilever acquiring more rental space, a Green Shoe Option (GSO) of up to Rs. 500m, for a maximum amount of PKR 5.1 Billion is also available on the facility. However, all terms for repayment as stipulated under this issue will remain the same.
- Following is the redemption schedule of the facility:

Table 2: Redemption Schedule

Date	Expected Markup Amount	Redemption/Principal Amount	Outstanding Principal
01-Oct-18			4,594,392,358
01 July-19	276,695,706	(338,335,317)	4,256,057,042
01 July-20	323,492,984	(372,168,848)	3,883,888,193
01 July-21	294,398,725	(409,387,823)	3,474,500,370
01 July-22	263,367,128	(450,324,512)	3,024,175,858
01 July-23	229,232,530	(495,354,829)	2,528,821,029
01 July-24	192,209,797	(544,888,218)	1,983,932,811
01 July-25	150,382,107	(599,378,299)	1,384,554,512
01 July-26	104,949,232	(659,312,098)	725,242,414
01 July-27	54,973,375	(725,242,415)	0

Profile of AHL and its long term plans

AHL belongs to 'The Avari Group', one of the prominent players in the hospitality sector. At present, AHL owns and manages five star hotel properties in two major cities of Pakistan including Karachi and Lahore along with separate commercial complexes used as rental office spaces. AHL also runs boutique hotels for its mid-tier clientele along with management control of a hotel and apartment hotel internationally. A 178 room four-star hotel facility, named 'Avari Dubai' along with an apartment hotel, 'Avari Suites – Al Barsha' comprising 78 suites are both located in United Arab Emirates. In order to close the demand supply gap, AHL has concerted efforts by increasing presence in main cities of Pakistan. AHL has also increased its focus towards corporate clients for growing its top line revenue. With its leased properties under the name of Avari Xpress (AX) shut down in Islamabad, the company developed a full-fledged 100 room hotel in Islamabad which is expected to follow a similar lease model as that of AX. In addition to this, a new 210 room hotel and apartment hotel are also being developed in Lahore. The company has developed new AX facilities at Multan and Faisalabad while it is exploring new cities for opportunities. These properties are leased from the owners on the basis of the lease rent being a percent of the revenue. In addition to this, the company has opened a boutique residence facility in Multan with a larger AX property to open in the coming years.

Financial Analysis of AHL

With improving law and order situation and higher tourism business during the year, AHL witnessed significant improvement in occupancy levels. AHL was able to grow its revenue base to Rs. 2.6b (FY16: Rs. 2.5b) in FY17; top line amounted to Rs. 1.4b in HY18. Revenues have largely remained a function of room rentals along with proceeds from food and beverages on a timeline basis. While gross margins of AHL have remained intact during the period under review, AHL projects margins to improve in the coming years on the back of greater supply of rooms. As a result, bottom-line of the company is also expected to showcase a double digit growth rate to Rs. 1.1b in the next two years. Bottom line will also be supported by better control over expenses along with growth in top-line. Margins are also expected to improve to 44.9% in FY20.

On account of internal capital generation, equity base (excluding surplus on revaluation of fixed assets) depicted a noticeable increase to Rs. 2.2b (FY16: Rs. 1.9b) at end-FY17; equity levels further increased to Rs. 2.4b at end-December 2017. Adjusting for surplus on revaluation of property, plant and equipment, equity levels augment to Rs. 17.2b at end-HY18. More than two-thirds of total capital employed is financed through debt resulting in a highly leveraged capital structure. Debt leverage and gearing were reported at 2.7x and 1.8x respectively at end December 30, 2017. Proceeds from the PPTFC are expected to retire a portion of the outstanding debt on AHL's books. As a result, debt leverage and gearing is expected to reduce to 1.6x and 1.1x, respectively by end-FY20. Remaining debt amounting to Rs. 1.6b will be retired by way of revenues from additional rooms to be brought online from 2018 onwards. Moreover, rental income from its other clients of AT are also expected to provide liquidity cushion for debt repayment. Furthermore this new PPTFC has no bearing on AHL's cash flows as it is totally secured against Unilever rentals and the risk of the same, based on the undertaking and covenants provided, will largely be borne by Unilever.

Avari Hotels (Pvt.) Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	Dec 30, 2017	June 30, 2017	June 30, 2016	June 30, 2015
Fixed Assets	21,401.8	21,383.9	21,207.6	21,093.9
Investments	15.1	0.1	0.1	0.1
Stock-in-Trade	27.0	19.3	14.6	19.3
Stores and spares	26.5	27.6	26.0	35.8
Trade Debts	620.8	596.5	144.5	131.0
Cash & Bank Balances	362.1	96.5	313.7	130.4
Total Assets	23,660.5	23,311.1	22,677.2	22,240.3
Trade and Other Payables	546.6	379.0	340.8	451.4
Total Debt *(*incl. current maturity)*	4,306.6	3,911.2	3,550.1	3,077.4
Tier-I equity *(*excl. surplus on revaluation of assets)*	2,369.3	2,221.4	1,930.7	1,656.5
Total Equity	17,250.7	17,102.7	16,812.1	16,537.9

INCOME STATEMENT	Dec 30, 2017	June 30, 2017	June 30, 2016	June 30, 2015
Net Sales	1,365.4	2,587.0	2,454.4	2,086.5
Gross Profit	552.7	1,055.7	1,005.0	784.8
Operating Profit	381.0	770.0	701.3	564.0
Profit After Tax	148.0	290.6	274.2	230.2

RATIO ANALYSIS	Dec 30, 2017	June 30, 2017	June 30, 2016	June 30, 2015
Gross Margin (%)	40.5	40.8	40.9	37.6
Net Working Capital	4.8	19.8	10.0	64.5
FFO to Total Debt (x)		0.08	0.08	0.1
FFO to Long Term Debt (x)		0.1	0.1	0.1
Debt Servicing Coverage Ratio (x)*		1.0	1.8	2.6
Debt Leverage(x)*	2.7	2.8	3.0	3.4
Gearing(x)*	1.8	1.8	1.8	1.9
ROAA (%)	1.3	1.3	1.2	1.1
ROAE (%)*	12.9	14.0	15.3	14.9

** Based on Tier-I equity*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Avari Hotels (Pvt.) Limited
Sector	Hospitality (Miscellaneous)
Type of Relationship	Solicited
Purpose of Rating	Instrument Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: BLR				
09/17/2018	AA	-	Stable	Preliminary

Facility Structure	Syndicated privately placed term finance certificate will be acquired in October 2018, amounting to Rs. 4.6b at a mark-up rate of 1 year KIBOR plus 0.25% and a tenor of 8 years and 10 months. The issue is secured by a first pari passu floating charge over Avari Hotel Karachi with a 25% margin. Principal repayments are to be made in nine annual stepped up installments which will begin from July 1, 2019.
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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