

RATING REPORT

Avari Hotels (Pvt.) Limited

REPORT DATE:

April 10, 2020

RATING ANALYSTS:

Muniba Abdullah, CFA
muniba.khan@vis.com.pk

RATING DETAILS

	Latest Rating	Previous Rating
Rating Category	Long-term	Long-term
Instrument Rating	AA	AA
Rating Date	Apr 10, 2020	Sept 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
<i>Beach Luxury Hotel Limited – 85%</i>	
<i>Avari International Hotels – 12%</i>	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates (May 2019)

<http://www.vis.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 (Pvt.) Limited (AHL) possesses over five decades of experience in the hospitality sector. AHL owns and manages two five star hotel properties in Pakistan, namely ‘Avari Towers Karachi’ (AT) and ‘Avari Lahore’ (AL). Avari Towers Karachi is a 225 room property which began operations in 1985. Avari Lahore commenced operations in 1978 and has a room count of 188. In order to cater to the mid-tier clientele, the company also manages boutique hotels under the brand name Avari Xpress (AX) in Islamabad, Multan, Lahore and Faisalabad and Avari Boutique Multan; the properties for these hotels have been acquired under lease contracts. AX has a total of 415 rooms to date. The company also manages a 178 room four-star hotel facility in Dubai on the basis of a Management Agreement.

Key Rating Drivers

Revenue base of the company continues to grow on the back of higher room rates vis-à-vis occupancy levels. Nonetheless, profitability indicators have reduced on account of higher expenses incurred.

In line with historical trends, revenue base of the company grew at a rate of 4% and amounted to Rs. 2.8b (FY18: Rs. 2.7b) by end-June 2019. Increase in top line is primarily attributed to increase in room rental rates. While occupancy levels have remained at largely unchanged for Karachi, the same have been negatively impacted for Lahore. Occupancy levels are expected to remain on the lower side for Lahore during the ongoing year. AHL is concerting efforts in order to improve business volumes emanating from corporate clients by increasing presence in main cities of Pakistan. While revenue base is largely contributed by room rentals, core revenues of the company also include proceeds from food and beverages on a timeline basis. With higher expenses, gross margins of AHL were reported lower at 38.7% (FY18: 40.2%) during FY19. For the year ending June 2019, the company incurred higher employee related costs on account of new hiring for its upcoming AX facilities. As a result, bottom-line of the company declined from 236.6m in FY18 to Rs. 75.2m in FY19.

Leverage indicators continue to remain on the higher side; capitalization levels grew on the back of internal profit generation.

On account of internal capital generation, equity base (excluding surplus on revaluation of fixed assets) depicted an increase to Rs. 2.53b (FY18: Rs. 2.46b) at end-FY19. Moreover, surplus on revaluation of property, plant and equipment continues to represent a sizeable proportion of the total equity base. Nonetheless, the company maintains a highly leveraged capital structure with more than two-thirds of total capital in the form of debt. Total debt of the company amounted to Rs. 2.0b (FY19: Rs. 3.3b) at end-December 2019. Debt leverage and gearing were reported at 2.9x and 1.3x respectively at end June 30, 2019. With lower profitability, Funds from Operations (FFO) declined significantly with FFO multiples worsening to 0.001x in FY19 vis-à-vis 0.04x in FY18. Going forward, debt repayment is expected to be supported by revenues from additional rooms brought online. AHL’s books also represent a financing facility amounting Rs. 4.3b which was mobilized for financing its expansion plans. Rental income from its prominent clients of AHL, Unilever, are expected to provide liquidity cushion for debt repayment of this facility.

Features of the New Facility Undertaken

AHL has mobilized a facility amounting to Rs. 4.3b from a syndicate of two banks, Meezan Bank Limited and Industrial & Commercial Bank of China Limited. The facility was disbursed in October 2019. Proceeds from the facility are planned to be utilized partially for expanding its properties while the remaining proportion will be used for retiring existing debt on the books; the company has already paid

off one of its existing facilities worth Rs. 1.5b. While the new facility will be present on the books of AHL, all principal and markup payments will be completely serviced by one of AHL's largest existing tenant, Unilever Pakistan Limited (Unilever). The security structure is tripartite [lenders, AHL and Unilever] with Unilever giving an undertaking to pay principal and markup payment on the facility 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.

Tenor of the facility will be 8 years and 10 months with markup and principal payable in 8 annual installments. Markup will be calculated on a 365-day year basis on the outstanding principal amount. 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. The agent bank will also maintain a profit bearing deposit which initially would amount Rs. 1.3b for servicing of markup relating to rentals of the second 5 year period of the lease discounted to present day.

Principal payments are in correspondence with the agreed upon rental rate, which will be escalated by 10% every year. 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, the agreement specifies that 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.

Avari Hotels (Pvt.) Limited
Appendix I

FINANCIAL SUMMARY					
<i>(amounts in PKR millions)</i>					
<u>BALANCE SHEET</u>	30-Jun-16	30-Jun-17	30-Jun-18	30-Jun-19	31-Dec-19
Fixed Assets	21,208	21,384	21,263	21,737	21,789
Trade Debts	145	597	709	615	633
Cash & Bank Balances	314	97	381	98	1,435
Total Assets	22,677	23,311	23,728	24,535	24,570
Trade and Other Payables	341	379	523	647	675
Total Debt <i>(*incl. current maturity)</i>	3,550	3,911	3,875	3,361	1,977
DM & LTFF (Self Liquidity Loan – Unilever)					4,282
Paid Up Capital	747	747	747	747	
Tier-I equity <i>(*excl. surplus on revaluation of assets)</i>	1,931	2,221	2,458	2,533	
Total Equity	16,812	17,103	17,136	17,212	
<u>INCOME STATEMENT</u>	30-Jun-16	30-Jun-17	30-Jun-18	30-Jun-19	31-Dec-19
Net Sales	2,454	2,587	2,713	2,811	1,504
Gross Profit	1,005	1,056	1,092	1,088	
Operating Profit	701	770	710	638	
Profit Before Tax	367	380	303	139	
Profit After Tax	274	291	237	75	
<u>RATIO ANALYSIS</u>	30-Jun-16	30-Jun-17	30-Jun-18	30-Jun-19	31-Dec-19
Gross Margin (%)	40.9	40.8	40.2	38.7	
Net Working Capital	10.0	19.8	1.7	33.3	
Current Ratio	1.01	1.01	1.00	1.01	
FFO to Total Debt (x)	0.08	0.08	0.04	0.001	
FFO to Long Term Debt (x)	0.1	0.1	0.1	0.001	
Debt Servicing Coverage Ratio (x)*	1.8	1.0	0.6	0.4	
Debt Leverage(x)*	3.0	2.8	2.7	2.9	
Gearing(x)*	1.8	1.8	1.6	1.3	
ROAA (%)	1.2	1.3	1.0	0.3	
ROAE (%)*	15.3	14.0	9.6	3.0	

* 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				
	04/10/2020	AA	-	Stable	Final
	09/17/2018	AA	-	Stable	Preliminary
Facility Structure	Islamic musharaka amounting Rs. 2b and conventional syndicated financing amounting Rs. 2.3b, was acquired in October 2019, at a mark-up rate of KIBOR plus 1% and a tenor of 8 years. 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 eight annual stepped up installments which will begin from May 2020.				
Statement by the Rating Team	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	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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2020 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meetings Conducted		Name	Designation	Meeting Date	
	1	Mr. Xerxes Avari	Director	February 12, 2020	
	2	Mr. Saeed Patel	Chief Financial Officer	February 12, 2020	