RATING REPORT

Avari Hotels (Pvt.) Limited

REPORT DATE:
June 09, 2021

RATING ANALYSTS:
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RATING DETAILS		
	Latest Rating	Previous Rating
Rating Category	Long-term	Long-term
Facility Rating	AA	AA
Rating Date	*June 09, 2021*	*Apr 10, 2020*

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: Corporates (May 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Avari Hotels (Pvt.) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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.

Avari Hotels (Pvt.) Limited (AHL) is engaged in the hospitality sector for more than five decades. 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 224 room property which began operations in 1985. Avari Lahore commenced operations in 1978 and has a room count of 186. 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 377 rooms to date.

<u>Key Rating Drivers</u>

Given the ongoing disruption due to COVID-19, the topline and profitability of the company has decreased on account of lower occupancy levels

Revenue base of the company decreased by 18% to Rs. 2.3b (FY19: Rs. 2.8b) in FY20. Decrease in revenue base was primarily a function of lower occupancy levels, which culminated to lower revenue from rooms, food and beverages. AX facilities were the only exception out of three properties, which witnessed increase in the occupancy levels in FY20 in comparison to the preceding year. Given the ever-changing dynamics of COVID-19 in the country, occupancy rates continue to remain impacted during the ongoing year. AHL's management is targeting higher business volumes from the corporate clients. Going forward, the management also plans to establish AX hotels in Gilgit and Naltar Valley as both these locations witness considerable inflow of tourists. Given the relatively lower decrease in the expenses in comparison to the revenues, both gross and net profits Rs. 657.3m (FY19: Rs. 1.1b) and Rs. 5.4m (FY19: Rs. 75.2m), respectively.

Leverage indicators continue to remain elevated; liquidity profile also depicts room for improvement

Equity base (excluding surplus on revaluation of fixed assets) depicted marginal increased to Rs. 2,538.6m (FY19: Rs. 2,533.2m) on account of profit retention. Surplus on revaluation of property continues to represent a sizeable proportion of the total equity base. Total equity including surplus amounted to Rs. 17.3b (FY19: Rs. 17.2b) at end-FY20. 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 witnessed increase to Rs. 5.2b (FY19: Rs. 3.4b) at end-FY20. The company mobilized facilities amounting to Rs. 4.3b from two banks, Meezan Bank Limited (MBL) and Industrial & Commercial Bank of China Limited (ICBC). Proceeds from these facilities are being partly utilized for expanding the properties while the remaining proportion was used for retiring other debt on the books. Given the significant quantum of debt on the books, leverage and gearing ratios remained elevated at 3.1x (FY19: 2.9x) and 2.1x (FY19: 1.3x). Given the decrease in profitability in FY20, Funds generated from Operations (FFO) were negative in FY20. Hence, liquidity profile indicates room for improvement. Rental income from prominent client of AHL, Unilever, is expected to provide liquidity cushion for debt repayment of this facility.

Facilities structure provides comfort to the rating

AHL mobilized facilities to the tune of Rs. 4.3b from two banks, Meezan Bank Limited and Industrial & Commercial Bank of China Limited. The facilities were disbursed in October 2019. All the principal and markup payments are being 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 and personal guarantee of sponsors.

Tenor of each facility is 7 years and 7 months with markup and principal payable in 8 annual installments. Payments are due in the month of May each year; first payment was serviced in May 2020 and the last payment will be due in May 2027. Latest annual payment due in May 2021 has been cleared. All markup and principal payments are made directly by Unilever into an account with the agent bank; this account is under lien with irrevocable instructions to retire debt as payments become due. The agent bank also maintains a profit bearing deposit initially amounting to 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	(amounts in PKR millions)		
BALANCE SHEET	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**
Property, Plant and Equipment	21,262.6	21,737.3	22,642.4
Investments	15.1	0.1	0.1
Long Term Deposits	28.3	37.8	37.8
Stock-in-Trade	15.8	16.8	15.7
Stores and spares	64.4	58.8	48.2
Income Tax Refundable	191.4	328.8	426.4
Trade Debts	709.4	615.3	106.7
Cash & Bank Balances	381.1	98.3	1092.7
Total Assets	23,728.2	24,535.3	25,118.9
Rent Received in Advance	1,208.5	1,602.9	463.3
Deferred Liabilities	656.9	1,189.4	819.9
Trade and Other Payables	522.7	646.7	786.7
Long Term Debt *(*incl. current maturity)*	2,876.2	2,236.2	4,464.1
Short Term Debt	998.5	1,124.7	774.9
Total Debt	3,874.7	3,360.9	5,239.0
Total Liabilities	6,591.8	7,323.8	7,785.8
Paid up Capital	747.3	747.3	747.3
Equity *(*excl. surplus on revaluation of assets)*	2,458.0	2,533.2	2,538.6
Total Equity	17,136.3	17,211.5	17,333.1
INCOME STATEMENT	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**
Net Sales	2,713.4	2,810.7	2,311.4
Gross Profit	1,091.7	1,087.5	657.3
Operating Profit	709.7	637.8	469.1
Profit Before Tax	303.1	138.7	40.1
Profit After Tax	236.6	75.2	5.4
CASH FLOW STATEMENT			
Funds From Operations (FFO)	166.3	2.2	-87.8
RATIO ANALYSIS	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**
Gross Margin (%)	40.2%	38.7%	28.4%
Net Margin (%)	8.7%	2.7%	0.2%
Net Working Capital	1.7	33.3	92.4
Current Ratio (x)	1.0	1.0	1.0
FFO to Total Debt (%)	4.3%	0.1%	-1.7%
FFO to Long Term Debt (%)	5.8%	0.1%	-2.0%
Debt Servicing Coverage Ratio (x)	0.6	0.4	0.3
Leverage(x)	2.7	2.9	3.1
Gearing(x)	1.6	1.3	2.1
(Stock in Trade + Trade Debts)/ Short Term Borrowings (%)	72.6%	56.2%	15.8%
ROA (%)	1.00%	0.31%	0.02%
ROE (%)*	9.6%	3.0%	0.2%

** Based on Equity excluding revaluation surplus*

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	see table below
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.
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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: BLR				
06/09/2021	AA		Stable	Reaffirmed
04/10/2020	AA	-	Stable	Final
09/17/2018	AA	-	Stable	Preliminary

Due Diligence Meetings Conducted

	Name	Designation	Meeting Date
1	Mr. Saeed Patel	Corporate Director Finance	May 31, 2021
2	Mr. Faisal Essani	Accountant	May 31, 2021