The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Services Limited | Sukuk | Mar-18

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Nov-2018	AA-	-	Stable	Maintain	-
29-Mar-2018	AA-	-	Stable	Initial	-
26-Oct-2017	AA-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

Ratings reflect Pakistan Services Limited's (The Company) strong position in the hospitality industry as the market leader drawing comfort from the Company's association with Hashoo Group. Pakistan Services Limited has witnessed growth over the years (in line with Industry dynamics) amid improving security conditions and progression of CPEC with stable margins. However, on going political scenario impacted the Company's profitability and coverages negatively during 3MFY19. The Company has modest leveraging. Relatively higher borrowings and rising interest rates have put coverages under pressure. This trend is expected to continue till cashflows from new properties start flowing in. The Company has sufficient liquid investments and cash to meet its obligations during FY19. Going forward, the Company is taking cost control measures to improve margins and is making sizable investments in development of new properties which are expected to augment its revenues.

Ratings are dependent on effective implementation of envisaged strategy while maintaining modest leveraging and improving coverages. Any significant delay in commencement of new projects, deterioration in margins/coverages and material dilution in liquid investments (other than debt repayment) will have a negatively impact on ratings.

Disclosure	
Name of Rated Entity	Pakistan Services Limited	Sukuk	Mar-18
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology	Corporate Ratings(Jun-18),Methodology	Sukuk(Jun-18),Methodology	Criteria	Rating Modifier(Jun-18),Methodology	Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study	Hotels & Retail Industry(May-18)
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Profile

Legal Structure Pakistan Services Limited (the Company) is a public listed company.

Background The company was incorporated in 1958 by the Government of Pakistan and Pakistan International Airlines, with four hotels in Karachi, Lahore, Rawalpindi and Peshawar. The hotels were managed by Intercontinental Hotel up until 1985, when they took an exit from Pakistan. Hashoo Group successfully bid for the hotel in the same year and commenced operations under the brand 'Pearl Continental Hotels'.

Operations The Company operates six luxury hotels under 'Pearl Continental' and one budget hotel under 'Hotel One'. The hotels are spread across all major cities of Pakistan with 1,556 rooms in total.

Ownership

Ownership Structure Major shareholding of the Company lies with Hashoo Group (89.2%) through foreign affiliates (64.8%), associated companies (22.6%) and directors (1.8%). Remaining shareholding is split between the general public and financial institutions.

Stability Ownership structure of the Company is stable as there is limited free-float and no ownership changes are expected.

Business Acumen Hashoo Group was established in 1960 by Sadruddin Hashwani, Chairman of the Group. The Group entered the hospitality industry by setting up its first hotel in 1978 and the second in 1981 under the brand 'Holiday Inn'. In the following years, the Group acquired Pakistan Services Limited and gained franchise rights for Marriott Hotels by Marriottt International.

Financial Strength Hashoo Group has business ventures spread across various industries, both, locally and internationally. The Hospitality division includes 'Marriott Hotels' in Islamabad and Karachi under Hashwani Hotels Limited. Moreover, Zaver Pearl Continental, located in Gwadar, is also operated by Hashwani Hotels.

Governance

Board Structure The Company's Board of Directors comprises nine members including three executive directors, five non-executive directors and one independent director.

Members' Profile The Board members have strong profiles and specialize in banking, finance and legal matters, in addition to hospitality.

Board Effectiveness The Company has in place two Board committees, namely, Human Resources and Remuneration Committee and Audit Committee. During the year the Board met five times, with high attendance by members.

Financial Transparency M/s KPMG Taseer Hadi & Co., Chartered Accountants, classified in category 'A' by SBP and having a satisfactory QCR rating, are the external auditors of the Company. They have expressed an un-qualified opinion on the financial statements.

Management

Organizational Structure The Company has a well-defined organizational structure. The highest level of authority lies with the Chief Executive who is aided by the Deputy Chairman and Vice Chairman. Similarly, management of the Hospitality division is headed by President of Hospitality.

Management Team Mr. Murtaza Hashwani, the Chief Executive Officer, has over two decades of experience relating to hospitality, oil & gas and pharmaceuticals. During the year Mr. Abdul Qadeer khan resigned from his position as Chief Financial Officer.

Effectiveness In order to ensure efficient operations, the Company relies on constructing and implementing strict budgets. Moreover, reports are submitted to top management to evaluate performance and devise future strategies.

MIS The company has centralized information services and has installed 'Opera', an integrated hotel management system.

Control Environment The Company has formed an efficient internal audit department, which reports to the Audit committee formed by the Board. The department works primarily in three dimensions i) Assurance, ii) Consulting and (iii) Investigation.

Business Risk

Industry Dynamics Recent growth in the economy, coupled with improving security conditions, has led to growth in Pakistan's hospitality sector. Additionally, progression of China Pakistan Economic Corridor (CPEC) has further boosted the industry. The luxury hotels space in Pakistan is largely dominated by a few major players as barriers to entry exist due to the capital intensive nature of the business.

Relative Position Pakistan Services Limited (PSL), operating under the brand 'Pear Continental' is the leading 5 star brand in the country with 1,526 rooms, followed by Sarena Hotels 828 rooms, Avari Hotels 508 rooms and Marriottt Hotels 505 rooms.

Revenues The Company generates its revenue from four sources, namely, rooms, food & beverage, other related services and shop license fee. Major portion of the revenue (~95% in FY18) emanates from rooms and food & beverage, with a marginal inclination towards revenue from rooms. During FY18, the Company posted revenues worth PKR 10,527mln, an increase of 7% over the preceding year. Growth can be attributed to higher demand, which led to increased occupancy rates and Average Daily Rates (ADR) during the period. During 3MFY19, the Company registered ~9% decline in revenue. Decline can be attributed to seasonality in the industry and the general elections, which were held on 25th July, 2018.

Margins During the year the Company witnessed a slight improvement in gross profit margin which stood at 46% in FY18, as compared to 45% in FY17, owing to better ADRs and improved occupancy rates. However, due to increased administrative costs the Company's operating profit margin suffered and stood at ~15% in FY18, coming down from 18% in the preceding year. Unrealized loss on revaluation of investments further aggravated the situation. Supplementary income in the shape of dividend, rental and interest provide cushion to the Company's overall profitability, with net profit closing in at PKR 496mln (FY17 1,149mln). During 3MFY19, the Company posted a loss of PKR 358mln due to high operating and finance costs. However, the Company is taking cost cutting measures, which are expected to come into effect in the near future.

Sustainability Going forward, the Company is in process of constructing two projects in Multan and Mirpur. Both projects are expected to come online in June, 2019. The Company is also in an agreement for managing a new hotel in Malam Jabba. Moreover, it is in the process of developing a high end residential building in Lahore, through its subsidiaries. The project is expected to start bookings from January, 2019.

Financial Risk

Working Capital Due to the largely cash based nature of the business, the Company was able to maintain a satisfactory position on its working capital management. The Company maintained a low number of trade receivable days and was able to improve trade payable days, impacting net working capital days positively and bringing it down to 15 days in FY18 (FY17: 22 days). Despite increased short-term borrowings, the Company maintains a healthy cushion to borrow additional funds, if needed. During 3MFY18, working capital management was stretched due to seasonality. Moreover, as the Company engaged in further short-term borrowings, room to borrow was squeezed.

Coverages During FY18, acquisition of new debt led to a reduced interest coverage ratio, which came down to 2.8x, as compared to 4.8x in the corresponding period. Similarly, total debt coverage ratio also took a hit and was recorded at 1.0x in FY18, compared to 2.2x in FY17. The situation worsened in 3MFY19 as lower FCFO coupled with higher finance costs and current maturity of long term debt resulted in an interest coverage and total debt coverage ratio of 0.8x and 0.3x, respectively. However, comfort can be drawn from sufficient liquid investments and cash which can be utilized to meet financial obligations.

Capitalization During the year the Company issued a privately placed Sukuk of PKR 7,000mln. The Company issued issued the first tranche amounting to ~PKR 2,333mln. Issuance of Sukuk, coupled with additional borrowings increased long-term borrowings by ~42% in FY18. Subsequently, the second tranche of PKR 1,362mln was issued in 3MFY19. However, despite surge in debt levels the Company was able to maintain a modest leveraging ratio, which stood at ~26% in 3MFY19 (FY17: 19%). Going forward, leveraging for the Company is expected to increase as the Company issues subsequent tranches of Sukuk in the next financial year.

Pakistan Services Limited

BALANCE SHEET	Sep-18	Jun-18	Jun-17	Jun-16
	3M	Annual	Annual	Annual
	Unaudited	*Audited*	*Audited*	*Audited*
Non-Current Assets	**42,180**	**41,495**	**34,789**	**32,864**
Investments (Others)	**6,907**	**6,236**	**2,462**	**2,291**
Current Assets	**2,396**	**2,808**	**5,090**	**1,498**
Store & Spare tools	201	194	176	188
Inventory	89	86	83	96
Trade Receivables	792	705	602	529
Other Current Assets	845	557	3,959	305
Cash & Bank Balances	469	1,267	271	379
Total Assets	**51,483**	**50,540**	**42,340**	**36,653**
Debt	**12,760**	**11,557**	**7,662**	**2,705**
Short-term	660	554	340	-
Long-term (Inlc. Current Maturity of long-term debt)	12,099	11,003	7,322	2,705
Trade Payables	478	549	263	296
Provision for Taxation	-	-	17	-
Other Liabilities	2,762	2,593	2,282	2,089
Shareholder's Equity	**35,483**	**35,840**	**32,116**	**31,564**
Total Liabilities & Equity	**51,483**	**50,540**	**42,340**	**36,653**

INCOME STATEMENT	Sep-18	Jun-18	Jun-17	Jun-16
Turnover	**2,282**	**10,527**	**9,812**	**9,151**
Gross Profit	808	4,880	4,382	4,379
Operating Profit	75	1,612	1,726	1,800
Other Income/(Expense)	(89)	1	351	(416)
Financial Charges	(225)	(726)	(412)	(168)
Taxation	(119)	(392)	(516)	(591)
Net Income	**(358)**	**496**	**1,149**	**625**

CASH FLOW STATEMENT	Sep-18	Jun-18	Jun-17	Jun-16
Free Cashflow from Operations (FCFO)	189	2,014	1,981	1,806
Net Cash changes in Working Capital	12	1,440	1,639	1,656
Net Cash from Operating Activities	(261)	1,574	1,643	2,013
Net Cash from InvestingActivities	(1,718)	(3,949)	(6,137)	(4,006)
Net Cash from Financing Activities	1,179	3,372	4,385	1,605
Net Cash generated during the period	(799)	996	(109)	(387)
Closing Balance of Cash & Equivalents	466	1,265	270	379

RATIO ANALYSIS	Sep-18	Jun-18	Jun-17	Jun-16
Performance				
Turnover Growth	-8.7%	7.3%	7.2%	15.5%
Gross Margin	35.4%	46.4%	44.7%	47.9%
Net Margin	-2.9%	14.9%	20.7%	14.6%
ROE	-2.0%	1.4%	3.6%	2.0%
Coverages				
(FCFO/Gross Interest+CMLTD)	0.3	1.0	2.2	2.7
(FCFO/Gross Interest)	0.8	2.8	4.8	10.8
(EBITDA/Gross Interest)	1.5	3.5	6.1	15.0
Liquidity and Cashflows				
Current ratio (X)	1.2	1.4	3.1	1.6
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days	23.8	15.1	22.2	20.6
Capital Structure				
Leveraging (Total Debt/Total Debt+Equity)	26.4%	24.4%	19.3%	7.9%

Regulatory and Supplementary Disclosure

Sukuk	
Placement	Unlisted, Secured, Privately Placed Sukuk
Issue size	PKR 7,000mln (inclusive of Green Shoe option of PKR 2,000mln)
Issue date	1st Tranche: March 2018; 2nd Tranche: July 2018
Tenor	6 Years from the date of issue with a 1.5 year grace period
Profit Rate	6Months KIBOR + 1% .
Principal Repayment	Nine (9) semi-annual installments commencing from the 6th month after the expiry of the grace period and subsequently every six (6) months thereafter till the issue tenor.
Call Option	Early redemption can be made after three years from the date of disbursement of 1st tranche with thirty (30) days notice. Early redemption will only be allowed on a principal installment date and in integral multiples of PKR 50mln. a pre-payment fee at 0.10% will be charged on the pre-paid amount.
Security	First Pari Passu Hypothecation charge over present and future moveable assets and First Pari Passu Equitable Mortgage on present and future immovable assets of PC Lahore with 25% margin.
Latest Book Value of Security- 30-Jun-18	PKR 15,608mln
Latest Market Value of Security-30-Jun-18	PKR 18,602mln
Trustee	Pak Brunei Investment Company Limited

Semi-Annual Installments	Year	Due Date	Days	Principal	Mark Up	Total Installment	Outstanding Balance
				------------PKR 000's ------------			
0	2018	Mar-18	-	-	-	-	2,333,333
1	2018	Sep-18	183	-	87,033	87,033	3,694,879
2	2019	Mar-19	182	-	195,644	195,644	3,694,879
3	2019	Sep-19	183	-	195,644	195,644	3,694,879
4	2020	Mar-20	182	410,542	195,644	606,186	3,284,337
5	2020	Sep-20	183	410,542	173,906	584,448	2,873,795
6	2021	Mar-21	182	410,542	152,167	562,710	2,463,253
7	2021	Sep-21	183	410,542	130,429	540,971	2,052,711
8	2022	Mar-22	182	410,542	108,691	519,233	1,642,168
9	2022	Sep-22	183	410,542	86,953	497,495	1,231,626
10	2023	Mar-23	182	410,542	65,215	475,757	821,084
11	2023	Sep-23	183	410,542	43,476	454,019	410,542
12	2024	Mar-24	182	410,542	21,738	432,280	0

Debt Instrument Rating Scale & Definitions

Debt Instrument credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Rating Symbol	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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