The Pakistan Credit Rating Agency Limited

Rating Report

Nishat Hotels and Properties Ltd

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	A-	A2	Stable	Maintain	-
27-Jun-2018	A-	A2	Stable	Maintain	-
29-Dec-2017	A-	A2	Stable	Maintain	-
23-Jun-2017	A-	A2	Stable	Maintain	-
30-Dec-2016	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Nishat Group, through Nishat Hotels & Properties Limited, has set up a project comprising a state of the art shopping mall, a luxury hotel and banquet halls. The ratings reflects the Company's association with Nishat Group, one of the leading business conglomerates of Pakistan, and expected group support. The Company successfully launched its mall segment in 2016. Certain modifications and expansion in original design led to some completion delays in the banquet & hotel segment, which were eventually inaugurated in April, 2017, and are now fully operational. Increase in personal disposable income in large cities has steadily improved consumption patterns and have welcomed the influx of branded non-essential items and luxury goods. With the mall operating at full capacity, the Company’s main focus is generating sufficient revenues from hotel operations. The Company incurred losses from operations. The financial profile remains stretched due to high leveraging, adequate working capital management, and weak coverages putting pressure on credit quality. The company has recently procured short term loans from associated companies for meeting working capital needs and fulfilling financial obligations.

Going forward, given sizable leveraging and debt obligations, group support remains critical for the ratings. Meanwhile, generation of cashflows from hotel operations and operating the mall at optimal capacity to reduce losses is critical.

Disclosure

Name of Rated Entity	Nishat Hotels and Properties Ltd
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(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)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Profile

Legal Structure Nishat Hotels & Properties Limited (the Company) is a public unlisted company.

Background The company was incorporated in October, 2007 and previously used to own and operate all hotel and real estate projects that come under Nishat Group. However, post 2013 the Company demerged all of its hotels into separate entities and now only manages the property located on Abdul Haque Road, Johar Town, Lahore.

Operations The Company's real estate project, more commonly known as The Emporium, comprises of a shopping mall, food court, multiplex cinema, banquet halls and a hotel. The Company commenced operations of its shopping complex in July, 2016, whereas, the hotel commenced operations in May, 2017. Subsequently, the Company expanded its hotel operations by adding two more floors which became operational in July, 2018.

Ownership

Ownership Structure The Company is a joint venture between Allied bank and Mansha Family. Major shareholding of the Company lies with Mansha Family (~90%), through Mian Hassan Mansha (~22%), Mian Raza Mansha (~22%), Mian Umer Mansha (~22%) and associated companies (~25%). The remaining shareholding (~10%) is held by Allied Bank.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected.

Business Acumen The Company is considered to have strong business acumen through Nishat Group, which is one of the leading business houses of Pakistan. It has been around for more than 60 years and has grown from a cotton export house to having a strong presence in the cement, textile, banking and power industries.

Financial Strength The Group has strong financial strength with a leading market position in textile, with its flagship entity, Nishat Mills. It is considered to be at par with multinationals in terms of quality products and management skills. During FY18, Nishat Mills, the Group's holding company had a consolidated asset base of ~PKR 140bln.

Governance

Board Structure The Company's Board of Directors comprises seven members including the Chairman, Chief Executive Officer and five non-executive directors.

Members' Profile Board members have strong profiles and specialize in banking, power, textile and cement, in addition to hospitality.

Board Effectiveness The Company lacks presence of board committees, however, board meetings are properly organized with minutes being captured in formal manner.

Financial Transparency A.F. Ferguson Chartered Accountants & Co., 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 for the year ending in June, 2018.

Management

Organizational Structure The Company has a well-defined organizational structure and is based on three departments, namely, finance, coordination and leasing. All department heads are reportable to the Chief Executive Officer.

Management Team Mr. Mian Hassan Mansha acts as the Chief Executive Officer of the Company. He has been with the Company since its inception and holds years of experience relating to real estate and power generation. He is aided by Mr. Khalid Qadeer Qureshi who acts as the Finance Director and is a fellow member of the Institute of Chartered Accountants of Pakistan with over 45 years of experience. Moreover, hotel operations are looked after by Mr. Shahid Abbas Khan who is the General Manger of the Hotel.

Effectiveness The Company has no management committees in place. However, management accounts are discussed among senior management to review monthly activity.

MIS The Company has deployed Oracle as its enterprise resource planning system. Reports are submitted to management on a daily, weekly and monthly basis.

Control Environment The Company's internal audit department is centralized and is shared between all group companies. The department has strict procedures and policies in place to ensure efficiency in reporting and standard operating procedures. Moreover, it conducts evaluations during the year and submits summarized reports to senior management. During the year 6 evaluations were performed by the department.

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. Moreover, Pakistan's retail industry has been improving recently. Growth in the urban middle class and increase in personal disposable income in large cities have slowly but steadily improved the consumption pattern and welcomed the influx of branded non-essential items and luxury goods.

Relative Position The Company has an insignificant market share with ~198 rooms. The industry is led by Pearl Continental with 1,556 rooms, followed by Sarena Hotels 828 rooms and Avari Hotels 508 rooms. The Company's mall, the Emporium, is of the main shopping destination in the city.

Revenues The Company sources its revenue from the following five segments: i) Rental Income, ii) Service and management charges, iii) Advertisement and parking income, iv) Room, banquet rent and services charges and v) Play zone income. Major portion of revenue emanates from rental income which represents ~50% of total revenue. During FY18, sales clocked in at ~PKR 3,736mln depicting a growth of ~52% over the preceding year. Growth can be seen as an effect of higher shop occupancy, which reached at full capacity during the year, and increased rental rates which are subject to annual increments. Additionally, revenue from the hotel (rooms and banquet rent) witnessed a surge as a full year of operations were observed in FY18, as opposed to only two months in the preceding period.

Margins Gross margin came under stress as the Company faced rising salaries and wages due to commencement of hotel operations. Moreover, increased repair and maintenance costs, high depreciation charges and a surge in banquet and hotel supplies put profitability under further stress. During FY18, gross margin came down to ~28% from 31% in the preceding year. On the other hand, an improvement in operating margin was observed. During FY18, the Company significantly improved its operating margin, which stood at ~16% as compared to 7% in the preceding year. This came about due to a substantial reduction in promotional activities and lower administrative costs during the year. The Company was able to improve its business profile during 3MFY19, with gross margin and operating margin improving to 25% (3MFY18: 20%) and 17% (3MFY18: 9%), respectively. However, high finance costs constrained profitability and led to a net loss of ~PKR 167mln in 3MFY19.

Sustainability Going forward, the Company is in process of expanding its Play Zone operations and has imported new rides which will become operational in the coming year.

Financial Risk

Working Capital The Company has been able to maintain a strong position on working capital management over the years through effective administration of debtors and creditors. During 3MFY19, net working capital days stood at 0 days (FY18: 9 days). However, the Company bears a neagtive impact of excess borrowings which have been utilized for capital expenditure. This results in a mis-match in the debt mix.

Coverages During FY18, the Company registered a significant improvement in FCFO, which grew by ~94% and stood at ~PKR 1,531mln. Increased FCFO can be seen as an effect of high revenues during the year. However, despite improved cash flows the Company maintained weak coverages due to a surge in financial charges. During FY18 interest coverage stood at 1.3x and debt coverage stood at 0.4x (FY17: interest coverage: 1.4x; debt coverage: 0.2x), representing the Company's weak ability to meet financial obligations. Coverages further deteriorated in 3MFY19, with interest coverage standing at 1.2x and debt coverage at 0.4x (3MFY18: interest coverage: 2.1x; debt coverage: 1.0x)

Capitalization The Company has an aggressive capital structure with a debt-to-equity ratio of ~69% in 3MFY19. Majority of the debt taken up is long-term in nature, representing ~56% of total debt which stood at ~PKR 21,021mln in 3MFY19 (FY18: ~PKR 21,092). The Company has entered into a syndicated arrangement with a consortium of banks to raise additional debt and meet debt servicing requirements. The Company has raised further debt to meet the upcoming principal and interest payments, along with re-profiling of the existing loan. Moreover, the company has procured short term loans from associated companies to meet working capital needs.

The Pakistan Credit Rating Agency Limited **Financials (Summary)**

PKR mln

Nishat Hotels & Properties Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M *Unaudited*	Annual *Audited*	Annual *Audited*	Annual *Audited*
Non-Current Assets	**14,622**	**14,617**	**15,017**	**11,395**
Current Assets	**2,993**	**2,910**	**2,100**	**2,414**
Inventory	-	-	-	-
Trade Receivables	298	228	154	-
Others	2,695	2,682	1,946	2,414
Total Assets	**27,351**	**27,363**	**26,931**	**22,428**
Debt	**18,021**	**18,092**	**17,020**	**12,284**
Short-term	1,498	897	1,489	-
Long-term (Inlc. Current Maturity of long-term debt)	13,523	14,194	14,531	12,284
Due to Related Parties	3,000	3,000	1,000	
Other shortterm liabilities	898	682	366	545
Other Longterm Liabilities	310	298	329	164
Shareholder's Equity	**8,121**	**8,291**	**9,217**	**9,435**
Total Liabilities & Equity	**27,351**	**27,363**	**26,931**	**22,428**

INCOME STATEMENT				
Turnover	**997**	**3,736**	**2,467**	**-**
Gross Profit	245	1,062	769	-
Other Income	10	21	19	10
Financial Charges	(350)	(1,176)	(581)	(2)
Net Income	**(170)**	**(926)**	**(218)**	**(91)**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	412	1,531	789	(290)
Net Cash changes in Working Capital	(28)	(519)	(482)	(369)
Net Cash from Operating Activities	83	(135)	(758)	(1,194)
Net Cash from InvestingActivities	(217)	(1,117)	(3,738)	(6,534)
Net Cash from Financing Activities	(70)	1,257	4,751	6,528

Ratio Analysis				
Coverages				
Interest Coverage (FCFO/Gross Interest)	1.2	1.3	0.8	-119.4
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	0.3	0.4	0.2	-0.1
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	0.4	0.4	0.2	-0.1
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCF(	6.4	7.4	9.1	-42.8
Capital Structure (Total Debt/Total Debt+Equity)	72.1%	71.8%	66.2%	22.2%

Rating Scale

Credit Rating Scale & Definitions

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.

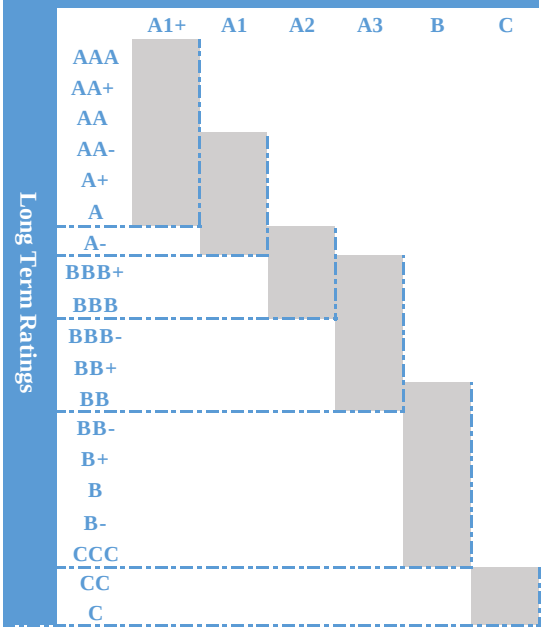
Long Term Ratings

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.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.

Short Term Ratings



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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(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)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(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)
Proprietary Information