



The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Services Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Mar-2020	A	A1	Negative	Downgrade	YES
20-Nov-2019	A+	A1	Developing	Maintain	YES
21-May-2019	A+	A1	Stable	Maintain	-
19-Nov-2018	A+	A1	Stable	Maintain	-
29-Mar-2018	A+	A1	Stable	Maintain	-
18-Aug-2017	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Pakistan Services Limited's (The Company) leading position in the hospitality industry. Ongoing geopolitical scenario, coupled with slowdown in domestic economic activity, impacted the Company's revenues and profitability. The situation has exacerbated with recent outbreak of COVID-19 pandemic and following travel restrictions. This is an industry wide phenomenon and has led to lower occupancies and severe pressure on revenues of players. The profitability of the Company is expected to suffer significantly and, despite better performance in 1HFY20, margins are expected to deteriorate on the back of COVID-19 outbreak. The Company has modest leveraging and a large asset base but higher finance cost and low cashflows have resulted in weak coverages. This trend is expected to continue as cashflows may further deteriorate. The management intends to dispose of some of its properties (real estate assets) to supplement liquidity and meet sizeable upcoming debt repayments. However, material progress is yet to be seen, as buyers are sidelined in current scenario of the industry. Financial support from sponsors remains imperative in the short term.

Ratings are dependent on effective implementation of envisaged strategy to improve cashflows while maintaining modest leveraging and strengthening coverages. Any significant delay in commencement of new projects and/or further deterioration in margins, leading to weak coverages and pressure on liquidity, will have a negative impact on ratings. Meanwhile, maintaining sufficient cushion for debt repayment remains crucial. Support from sponsors is critical.

Disclosure

Name of Rated Entity	Pakistan Services Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Hotels & Retail Industry(May-19)
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Profile

Legal Structure Pakistan Services Limited (the Company) is a public limited company, quoted on the Pakistan Stock Exchange.

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 Hotels & Resorts up until 1985, after which they took an exit from Pakistan. Subsequently, Hashoo Group successfully bid for the hotels in the same year and commenced operations under the brand 'Pearl Continental Hotels'.

Operations Pakistan Services Limited 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 1,526 rooms under six Pearl Continentals and 32 rooms in Hotel One Lahore.

Ownership

Ownership Structure Majority stake in Pakistan Services Limited is owned & controlled by Hashoo Group & its affiliates. The remaining shareholding is held through local associated companies and directors.

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 penetrated 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 Marriott International. The sponsor have considerable expertise in hospitality sector.

Financial Strength The Company's financial strength is derived from the support of its Group. The Group has business ventures spread across various industries, both, locally and internationally. The Group activities encompass hospitality, oil & gas exploration and production, information technology, minerals, pharmaceuticals, real estate and commodity trading. In addition to operating Pearl Continental through Pakistan Services Limited, the Group operates two Marriott Hotels (Islamabad and Karachi) and one property of Pearl Continental located in Gwadar and a chain of budget hotels under Hotel One (Pvt.) Limited through Hashwani Hotels Limited.

Governance

Board Structure The Company's Board comprises nine members. Three are Executive Directors, five are Non-Executive Directors and one is an Independent Director.

Members' Profile Mr. Sadruddin Hashwani, Chairman of the board, possesses more than four decades of experience in hospitality sector. Other Board members also have well diversified and extensive profiles. They include professional accountants, lawyers and experienced individuals from hospitality industry.

Board Effectiveness The board has formed two committees namely; i) Audit Committee and ii) Human Resource committee to comply with the code of corporate governance. During the FY19, five board meetings were held in which attendance of the board members remained adequate. The Company maintains board meeting minutes in a proper manner.

Financial Transparency KPMG Taseer Hadi & Co. is the external auditor of the Company. The auditor has given an unqualified opinion on the financial statements for year ended June 30th, 2019.

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 Vice Chairman.

Management Team Mr. Murtaza Hashwani is the CEO of the Company. He is a graduate from Santa Monica University, USA, and carries experience of over 2 decades managing hospitality, oil & gas and pharmaceutical sectors. Mr. Javed Iqbal, the Company's CFO, is an experienced Chartered Accountant. Other members of management tier are all seasoned professionals with relent experience.

Effectiveness In order to ensure efficient operations, the Company relies on constructing and implementing strict budgets. Moreover, to devise future strategies while evaluating current performance, various reports on a frequent basis are submitted to the top management.

MIS The Company has implemented 'Opera', an integrated, cloud-based, management system designed specifically for the hospitality industry by Oracle.

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

Business Risk

Industry Dynamics Improvement in infrastructure, coupled with improving security conditions, led to growth in Pakistan's hospitality sector in past few years. Additionally, progression of China Pakistan Economic Corridor (CPEC) 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. However, slowdown in Pakistan's economic growth from FY19, geopolitical tensions and global outbreak of Covid-19 pandemic are expected to dampen the demand for luxury hotels and affect all players in the industry.

Relative Position Pakistan Services Limited, operating under the brand 'Pearl Continental', is the leading 5 star brand in the country with 1,526 rooms, followed by Serena Hotels, Avari Hotels and Marriott Hotels, respectively.

Revenues The Company generates its revenue from four sources, namely, rooms (largest contributor), food & beverage, other related services and shop license fee. During FY19, the Company posted revenues worth PKR 10,138mln (FY18: PKR 10,527mln), a decrease of 4.5% YoY due to lower room revenue (by 13%). This can be attributed to lower demand, which led to fall in occupancy rates to 58% in FY19 (FY18: 64%). During 1HFY20, revenues increased by ~6% to PKR 5,331mln (1HFY19: PKR 5,036mln) due to increase in occupancy rates. However, improvement in occupancy rates is unlikely to be sustainable amid current global and local travel restrictions due to Covid-19 outbreak.

Margins During FY19, the Company witnessed a decline in gross profit margin, which decreased to 40.1% (FY18: 46%). Gross profit margin decreased on the back of lower revenue YoY. Impact of lower revenue combined with higher operating expenses, resulted in operating profit margin declining to 10.1% (FY18: 16.7%) despite cost control measures by the Company. The Company recorded a net loss of PKR 863mln in FY19, a significant drop from profit of PKR 495mln in FY18. This decline is mainly due to higher finance costs (FY19: PKR 1,154mln, FY18: PKR 726mln) and lower operating income. Gross profit margin slightly increased in 1HFY20 to 41% and operating profit margin to 10%. Net loss also decreased and clocked in at PKR 90mln (1HFY19: loss of PKR 420mln) due to higher revenues.

Sustainability Going forward, improvement in profitability and margins would be critical at a time when occupancy rates are expected to experience a significant drop due to travel restrictions. The Company intends to sell certain real estate assets to supplement cashflows.

Financial Risk

Working Capital During FY19, the Company was able to maintain a strong position on its working capital management with net working capital cycle at 8days (FY18: 12days). Moreover, increase in short term borrowings to PKR 1,265mln (FY18: PKR 570mln) during the period reduced the Company's cushion to borrow additional funds, if needed. During 1HFY20, the Company's net working capital cycle further improved to -2days, while its short-term borrowings increased significantly to PKR 2,569mln. This has created a mismatch at trade asset level. Materialization of initiatives to improve cashflows is critical for the Company, in order to eliminate asset liability mismatch.

Coverages During FY19, the Company's free cashflows from operations declined to PKR 1,525mln (FY18: PKR 2,014mln) due to the loss of PKR 863mln, whereas finance cost increased on YoY basis. The interest coverage ratio fell to 1.4x (FY18: 3.5x) and debt coverage ratio to 0.4x (FY18: 1x). Coverages improved in 1HFY20, with interest coverage ratio increasing to 1.5x and debt coverage ratio to 0.4 due to increase in FCFO by ~37% (1HFY20: PKR1,083mln, 1HFY19: PKR 792mln). Sustainability of improving FCFO and consequently coverages will be tested in the current macroeconomic environment.

Capitalization The Company issued a privately placed Sukuk worth PKR 7,000mln during FY18. Total borrowings during FY19 witnessed an increase of ~30% and clocked in at PKR 15,604mln (FY18: PKR 11,594mln), primarily on the back of full draw down of the Sukuk. The Company was able to maintain a modest leveraging ratio of 30.9% (FY18: 24.5%) despite increase in total borrowings due to its strong equity base. Leveraging ratio during 1HFY20 clocked in at ~32% remaining almost stagnant.



Pakistan Services Limited Hotel & Retail Industry	Dec-19 6M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	44,401	42,582	41,495	34,685
2 Investments	4,651	4,525	3,183	1,424
3 Related Party Exposure	4,530	4,514	3,083	1,166
4 Current Assets	2,529	2,435	2,778	5,065
<i>a Inventories</i>	90	86	86	83
<i>b Trade Receivables</i>	788	543	705	602
5 Total Assets	56,111	54,056	50,540	42,340
6 Current Liabilities	3,429	2,323	2,188	1,732
<i>a Trade Payables</i>	1,146	463	549	263
7 Borrowings	16,498	15,604	11,557	7,662
8 Related Party Exposure	43	21	15	20
9 Non-Current Liabilities	1,326	1,204	939	810
10 Net Assets	34,815	34,905	35,840	32,116
11 Shareholders' Equity	34,815	34,905	35,840	32,116

B INCOME STATEMENT

1 Sales	5,331	10,138	10,527	9,812
<i>a Cost of Good Sold</i>	(3,147)	(6,068)	(5,647)	(5,430)
2 Gross Profit	2,185	4,070	4,880	4,382
<i>a Operating Expenses</i>	(1,651)	(3,230)	(3,268)	(2,697)
3 Operating Profit	534	840	1,612	1,685
<i>a Non Operating Income or (Expense)</i>	305	(55)	1	392
4 Profit or (Loss) before Interest and Tax	839	785	1,613	2,077
<i>a Total Finance Cost</i>	(775)	(1,154)	(726)	(412)
<i>b Taxation</i>	(154)	(494)	(392)	(516)
6 Net Income Or (Loss)	(90)	(863)	496	1,149

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	1,083	1,525	2,014	2,001
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	129	162	1,385	1,597
<i>c Changes in Working Capital</i>	625	(117)	134	4
1 Net Cash provided by Operating Activities	754	44	1,518	1,601
2 Net Cash (Used in) or Available From Investing Activities	(1,135)	(5,035)	(3,894)	(6,095)
3 Net Cash (Used in) or Available From Financing Activities	504	3,965	3,373	4,386
4 Net Cash generated or (Used) during the period	124	(1,026)	997	(108)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	5.2%	-3.7%	7.3%	7.2%
<i>b Gross Profit Margin</i>	41.0%	40.1%	46.4%	44.7%
<i>c Net Profit Margin</i>	-1.7%	-8.5%	4.7%	11.7%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	23.1%	21.1%	24.3%	25.6%
<i>e Return on Equity (ROE)</i>	-0.5%	-2.4%	1.5%	3.6%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	26	26	26	25
<i>b Net Working Capital (Average Days)</i>	-2	7	11	16
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	0.7	1.0	1.3	2.9
3 Coverages				
<i>a EBITDA / Finance Cost</i>	1.7	2.0	4.4	7.6
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.4	0.4	1.0	2.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	21.1	30.9	7.7	4.4
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	32.2%	30.9%	24.4%	19.3%
<i>b Interest or Markup Payable (Days)</i>	135.2	130.7	141.1	114.3
<i>c Average Borrowing Rate</i>	8.9%	7.8%	6.0%	4.3%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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

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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.
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- (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)

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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)
- (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)

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- (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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