The Pakistan Credit Rating Agency Limited

PAKISTAN SERVICES LIMITED

RATING REPORT

	INITIAL [AUG-17]
Long-Term	A+
Short-Term	A1
Outlook	Stable

AUGUST 2017

Profile &Ownership

- Pakistan Services Limited (PSL) was incorporated in the year 1958 by GoP and PIA with the objective of establishing an intercontinental hotel in Karachi.
- Hashoo group bid successfully for the company in 1985 when intercontinental hotels were taking exit from Pakistan. Hashoo Group renamed existing brand of intercontinental hotels as "Pearl Continental Hotels".
- Pearl continental is the leading 5 star hotel chain of the country with presence in all major cities of Pakistan.
- Hashoo Group directly and through its affiliates has 89.15% control in Pakistan Services Limited
- The Hashoo Group of companies owns and operates, the Pearl Continental Hotels, Marriott Hotels and The Hotel one.

Governance

- BoD comprises nine members including three executive director, five non-executive and one independent director.
- Mr. Saddrudin Hashwani is the chairman of the board. He has over 5 decades of experience in trading, hospitality, oil & gas and other sectors.
- The board has formed Audit committee and Human Resource & Remuneration committee to comply with code of corporate governace.

Management

- Mr. Murtaza Hashwani – member of sponsor family, oversees hospitality business of the Hashoo group. He is the Chief Executive Officer of the company.
- Hospitality division is further subdivided into sub divisions which includes (i) Sales, Marketing and Revenue (ii) Human Resource (iii) Finance (iv) Operations. (v) Procurement (vi) IT and (vii) Internal Audit.
- All the hotels have its own management team. Hotel management team is headed by General Manager who reports directly to the Vice president - Operations.

Systems & Controls

- The company controls and make major decisions from the corporate office Islamabad. Majority of the systems are centralized.
- PSL has deployed the best systems available in the market. It has installed 'Opera' at its hotels, which is an integrated hotel management system, facilitating information management and decision-making in the hospitality industry.
- The management is in the process of centralizing whole information systems which will enable management of the systems centrally from PSL's corporate office in Islamabad.

Performance

- Pakistan's hospitality industry is growing and it's in expansion mode benefitting from improved economic and security conditions. Many local and international players are entering into hospitality businesses. PSL has competitive advantage over its competitors due to its geographical presence all over the country.
- The company has witnessed continuous growth in the revenues (9MFY17: PKR 7,553mln, FY16: PKR 9,151mln, FY15: PKR 7,922mln) owing to improvement in economy and overall security condition of the country.
- Increased ADRs, higher occupancies and healthy gross margins led to strong profitability of the company (9MFY17: PKR 1,173mln. FY16: PKR 625mln).
- Going forward the company is planning to diversify into real estate in addition to expanding its hotel network. The company plans to undertake these expansion projects with an aim to further strengthen its position in the domestic hospitality industry.

Financial Risk

- The company enjoys negative net cash cycle (9MFY17: -46days, FY16: -41days, FY17: -30) mainly benefiting from cash based business model of hospitality industry.
- Company maintains a low leveraged capital structure (9MFY17: 17.5%; FY16: 7.8%). The company's plans of expansion will be financed through a combination of additional new long term debt or issuance of Sukuk.
- The company's debt service coverage is strong but declined over the last year owing to acquisition of new debt (9MFY17: 3.4, FY16: 2.7 FY15: 7.9). The company's projected coverage on the back of additional debt is expected to decline further. However, cashflows from new projects are likely to strengthen future cashflows, in turn, coverages.

RATING RATIONALE

Pakistan Services Limited (PSL) is the owner and operator of Pearl Continental (PC) Hotels in Pakistan. PC is the premium five star hotel chain of the country. The rating reflects the leading position of the PC brand in the domestic market alongwith a diversified geographical presence of its hotels, providing competitive edge over other players. PSL currently has presence in six major cities. The rating incorporates association of PSL with Hashoo group – leader in the domestic hospitality market with over 2500 rooms in 20 properties. PSL has observed continuous growth in Occupancies and Average Daily Rates – facet of improved security situation and increased economic activity in the country. PC – Lahore is the biggest hotel with 600+ rooms contributing ~45% to the overall revenue stream. The profitability trend is observing improvement. The company currently has a low leveraged capital structure. The improving trend of the cashflows resulted in sound coverages for PSL. Notably, the company has formulated a reasonable financial matrix capturing maximum debt and desired coverage levels.

KEY RATING DRIVERS

In order to capitalize on the increasing demand in the hospitality sector, PSL targets sizeable investments in expansion and development of new properties in both high-end and mid-tier segments. The company plans to enter real estate housing and mega mall projects through its subsidiaries. The debt driven expansions would increase the company's leveraging. Management of coverages amidst rising debt levels would remain crucial. Herein, compliance with finance framework is important. Timely completion of under construction properties improving the cashflow stream would provide support to the coverages.

Pakistan Services Limited *PKR mln*

BALANCE SHEET	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	9M	Annual	Annual	Annual
Non-Current Assets	**37,631**	**32,845**	**30,092**	**25,535**
Investments (Others)	**1,160**	**1,083**	**950**	**938**
Current Assets	**3,152**	**2,706**	**3,305**	**2,972**
Store & Spare tools	173	188	150	146
Inventory	94	96	91	87
Trade Receivables	752	529	510	584
Other Current Assets	1,762	1,514	1,787	1,993
Cash & Bank Balances	370	379	766	162
Total Assets	**41,943**	**36,634**	**34,346**	**29,444**
Debt	**6,839**	**2,687**	**760**	**598**
Short-term	782	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	**6,057**	**2,687**	**760**	**598**
Trade Payables	1,964	1,603	1,633	1,865
Provision for Taxation	-	-	-	38
Other Liabilities	818	789	683	678
Shareholder's Equity	**32,322**	**31,555**	**31,271**	**26,266**
Total Liabilities & Equity	**41,943**	**36,634**	**34,346**	**29,444**
INCOME STATEMENT				
Turnover	**7,553**	**9,151**	**7,922**	**7,610**
Gross Profit	3,444	4,379	3,633	3,359
Operating Profit	1,528	1,800	1,372	1,396
Other Income/(Expense)	360	(416)	269	612
Financial Charges	(288)	(168)	(103)	(131)
Taxation	(427)	(591)	(486)	(473)
Net Income	**1,173**	**625**	**1,052**	**1,403**
CASH FLOW STATEMENT				
Free Cashflow from Operations (FCFO)	1,771	1,806	1,407	1,574
Net Cash changes in Working Capital	1,516	1,656	1,252	1,445
Net Cash from Operating Activities	1,416	2,013	1,024	1,465
Net Cash from InvestingActivities	(5,329)	(4,006)	(578)	(1,326)
Net Cash from Financing Activities	3,903	1,605	158	(8)
Net Cash generated during the period	(9)	(387)	604	131
Closing Balance of Cash & Equivalents	370	379	766	162
RATIO ANALYSIS				
Performance				
Turnover Growth	8.2%	15.5%	4.1%	11.9%
Gross Margin	45.6%	47.9%	45.9%	44.1%
Net Margin	25.0%	14.6%	20.3%	26.1%
ROE	3.7%	2.0%	3.6%	5.3%
Coverages				
Debt Service Coverage				
1. (FCFO/Gross Interest+CMLTD)	3.4	2.7	7.9	4.2
2. (FCFO/Gross Interest)	6.1	10.8	13.7	12.1
3. (EBITDA/Gross Interest)	7.6	15.0	19.8	14.9
Liquidity and Cashflows				
Current ratio (X)	1.1	1.6	2.0	1.5
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-45.6	-31.5	-40.6	-50.3
Capital Structure (Total Debt/Total Debt+Equity)	17.5%	7.8%	2.4%	2.2%

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.

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

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.

Name of Rated Entity	Pakistan Services Limited
Sector	Hospitality
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Related Criteria and Research

Rating Methodology	Corporate Rating Methodology
Sector Research	Hotels & Retail Industry - Viewpoint | Mar-17

Rating Analysts

Muhammad Hassan	Rai Umar
muhammad.hassan@pacra.com	nadeem@pacra.com
(92-42-35869504)	(92-42-35869504)

Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping
PACRA maintains principle of integrity in seeking rating business.
PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable

but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.

Conflict of Interest
PACRA, 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 done by them
The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA
The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees
PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities
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 ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance
PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality
PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition
None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA’s written consent. PACRA reports and ratings constitute opinions, not recommendations to buy or to sell

Probability of Default (PD)

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