The Pakistan Credit Rating Agency Limited

PAKISTAN SERVICES LIMITED
PRIVATELY PLACED SUKUK OF PKR 7 BILLION | TBI

RATING REPORT

	PRELIMINARY [OCT-17]
Long-Term	AA-
Short-Term	-
Outlook	Stable

OCTOBER 2017

About the Sukuk

- Pakistan Services Limited (PSL) is in the process of issuing a privately placed, unlisted, secured Sukuk of PKR 7bln (inclusive of PKR 2bln green-shoe option).
- Proceeds of the issue will be utilized for PSL's future projects as well as for renovation of existing properties.
- Tenor of the Sukuk will be 6 years with initial 1.5 years as grace period. The issue has profit (6MK+1%) payable semiannually in arrears. The Sukuk's principal repayment will start after 18th month of issue date in 9 semi-annual installments.
- The instrument, is secured by Equitable Mortgage charge on land and building of PC-Lahore with 25% margin.
- PSL will be maintaining a DPA account and it has committed to maintain a cushion for repayment in its short term financing facilities during tenure of the Sukuk.

Issuer Profile

- 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 & its affiliates directly have 89.15% control on Pakistan Services Limited.
- The Hashoo Group of companies controls and operates, the Pearl Continental Hotels, Marriott Hotels and The Hotel one.

Governance & Management

- BoD comprises nine members including three executive director, five non-executive and one independent director.
- Mr. Sadruddin Hashwani is the chairman of the board. He has over 5 decades of experience in trading, hospitality, oil & gas and other sectors.
- 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.
- PSL has deployed strong internal controls and effective information technology systems to ensure effective management.

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 (FY17: PKR 9,812mln, FY16: PKR 9,151mln) 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 (FY17: PKR 1,146mln, FY16: PKR 625mln FY15: PKR 1,071mln).
- 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 short net cash cycle (FY17: 22 days, FY16: 22 days), mainly benefiting from cash based business model of hospitality industry.
- Company maintains a low leveraged capital structure (FY17: 19.2%; FY16: 7.8%). The company's plans of expansion will be financed through a combination of additional new long term debt and issuance of Sukuk.
- The company's debt service coverage is strong but declined over the last year owing to acquisition of new debt (FY17: 2.2x, FY16: 2.7x). 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 PSL providing competitive edge over other players. PSL currently has presence in six major cities. The rating also incorporates the association of PSL with the Hashoo group – market leader in the domestic hospitality market with over 2500 rooms in 20 properties. To solidify its market position, PSL is constructing five star hotels in Multan & Mirpur, later will be partially financed through this Sukuk. PSL has observed continuous growth in occupancies and ADRs – facet of improved security situation and increased economic activity in the country. PC – Lahore is the biggest hotel with 607 rooms contributing ~45% of the overall revenue stream. The profitability trend also observed improvement. The company currently has a low leveraged capital structure but debt driven expansions would increase the company's leveraging though remaining at a comfortable level. PSL intends to maintain a debt payment account for servicing its financial obligations. To ensure liquidity cushion the company plans to maintain a cushion in its short term lines equivalent to the upcoming installment amount, which further provides comfort to the ratings.

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 also plans to enter into the real estate housing and mega mall projects through its subsidiaries. Management of coverages amidst rising debt levels would remain crucial. Timely completion of under construction properties improving the cashflow stream would provide support to the coverages.

Pakistan Services Limited

PKR mln

BALANCE SHEET	30-Jun-17	30-Jun-16	30-Jun-15
	Annual	Annual	Annual
Non-Current Assets	**34,668**	**32,845**	**30,092**
Investments (Others)	**1,192**	**1,083**	**950**
Current Assets	**6,463**	**2,706**	**3,305**
Store & Spare tools	176	188	150
Inventory	83	96	91
Trade Receivables	602	529	510
Other Current Assets	5,332	1,514	1,787
Cash & Bank Balances	271	379	766
Total Assets	**42,323**	**36,634**	**34,346**
Debt	**7,649**	**2,687**	**760**
Short-term	340	-	-
Long-term (Inlc. Current Maturity of long-term debt)	**7,309**	**2,687**	**760**
Trade Payables	1,656	1,603	1,633
Provision for Taxation	-	-	-
Other Liabilities	913	789	683
Shareholder's Equity	**32,104**	**31,555**	**31,271**
Total Liabilities & Equity	**42,323**	**36,634**	**34,346**
INCOME STATEMENT			
Turnover	**9,812**	**9,151**	**7,922**
Gross Profit	4,385	4,184	3,633
Operating Profit	1,722	1,800	1,372
Other Income/(Expense)	351	(416)	289
Financial Charges	(411)	(168)	(103)
Taxation	(516)	(591)	(486)
Net Income	**1,146**	**625**	**1,071**
CASH FLOW STATEMENT			
Free Cashflow from Operations (FCFO)	1,974	1,807	1,408
Net Cash changes in Working Capital	1,591	1,656	1,253
Net Cash from Operating Activities	1,595	2,014	1,024
Net Cash from InvestingActivities	(6,095)	(4,006)	(578)
Net Cash from Financing Activities	4,392	1,605	158
Net Cash generated during the period	(108)	(387)	604
Closing Balance of Cash & Equivalents	271	379	766
RATIO ANALYSIS			
Performance			
Turnover Growth	7.2%	15.5%	4.1%
Gross Margin	44.7%	45.7%	45.9%
Net Margin	11.7%	6.8%	13.5%
ROE	3.6%	2.0%	3.7%
Coverages			
Debt Service Coverage			
1. (FCFO/Gross Interest+CMLTD)	2.2	2.7	7.9
2. (FCFO/Gross Interest)	4.8	10.8	13.7
3. (EBITDA/Gross Interest)	6.1	15.0	19.8
Liquidity and Cashflows			
Current ratio (X)	3.1	1.6	2.0
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	22.2	21.6	16.2
Capital Structure (Total Debt/Total Debt+Equity)	19.2%	7.8%	2.4%

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

Name of Rated Entity Pakistan Services Limited
Sector Hospitality
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment

Instrument Details

Nature of Instrument	Size of Issue	Tenor (yrs)	Security	Issue Agent
Sukuk	7000mln (inclusive of 2,000mln greenshoe option	6	First Pari Passu charge over Current and future movable and immovable assets of PC - Lahore	Faisal Bank Limited

Repayment Schedule Refer to Annexure

Related Criteria and Research

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

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Rating Team Statement

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Probability of Default (PD)

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PSL SUKUK Repayment Schedule

Year	Opening	Principal Repayment	Interest Payment	Total Installment	Remaining Balance
0	7,000	**Grace Period**		-	7,000
	7,000		250	250	7,000
1	7,000		250	250	7,000
	7,000	778	250	1,028	6,222
2	6,222	778	222	1,000	5,444
	5,444	778	195	972	4,667
3	4,667	778	167	945	3,889
	3,889	778	139	917	3,111
4	3,111	778	111	889	2,333
	2,333	778	83	861	1,556
5	1,556	778	56	833	778
	778	778	28	806	(0)
		7,000	1,752	8,752	