The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Services Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2024	BB	A4	Negative	Maintain	Yes
29-Dec-2023	BB	A4	Negative	Downgrade	Yes
25-Jul-2023	BBB	A3	Negative	Downgrade	Yes
15-Mar-2023	A-	A2	Negative	Downgrade	Yes
24-Mar-2022	A	A1	Developing	Maintain	Yes
24-Mar-2021	A	A1	Negative	Maintain	Yes
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	-

Rating Rationale and Key Rating Drivers

Pakistan Services Limited (“PSL or The Company”) has a leading position in the hospitality industry. Under brand name “PC-Pearl Continental Hotels & Resorts” the Company owns and manages 5 hotels in different cities. As part of its diversification strategy towards an asset-light model, the company also operates and manages PC-Hunza under the brand name “PC-Legacy”. According to the “World Tourism Barometer” published by the World Tourism Organization, Pakistan experienced a 92% growth in foreign visitors in the first nine months of 2023, indicating a positive trend compared to pre-pandemic levels. Pakistan's hotel and retail industry is experiencing growth due to factors like rising consumer spending, urbanization, and improved infrastructure. This has led to domestic and international hotel chains expanding their properties to meet the growing demand for quality accommodations in luxury, business, and budget segments. On the flip side, soaring inflation, along with high interest rates, escalates the cost of doing business and creating a constant challenge for the industry. During 9MFY23 revenues of PSL recorded ~10.6% growth mainly due to increase in Food & beverages revenue. Margins also showed improvement at all levels and this led to an increase of free cashflows. However, cash flow generation remains inadequate to meet the debt obligations, a situation acknowledged by management and disclosed in the latest published financial statements, highlighting the existence of significant material uncertainty. Previously as per the consent and approval of lenders all long-term loans have been restructured, where principal repayments and along with markup for the quarter ended Mar 23, June 23 & Sep 23 were deferred till Dec 23 and became payable with Dec 23 quarter payment. As of now the company successfully sold one of the identified properties and utilized its proceeds to pay the debt obligations which were due till Dec 23. The Company has formally requested to their lenders for restructuring of remaining long-term loan also, and the negotiations are still under way. March 24 quarter payment is now also due, and the management expects to pay it from internal cashflows before the end Jun 24. According to the management representation there is no change in the security and pricing structure of these loans. The Company is actively seeking a suitable buyer for the under-construction PC Multan which is classified under asset held for sale, but has not yet made substantial progress. The Financial risk profile of the Company is characterized by weak coverages.

Ratings are dependent on effective implementation of envisaged strategy, maintaining sufficient cushion for debt repayment and sponsor's support remains crucial. Outlook on the entity is negative while rating watch is maintained. Removal of material uncertainty related to going concern as documented by the external auditors is important.

Disclosure

Name of Rated Entity	Pakistan Services Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-23)
Related Research	Sector Study | Hotel & Lodging(Jun-24)
Rating Analysts	Kanwal Ejaz | kanwal.ejaz@pacra.com | +92-42-35869504

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 (PSL) operates eight luxury hotels with 1,702 total rooms in all major cities i.e. Karachi, Lahore, Rawalpindi, Bhurban, Muzafarabad, Hunza, Murree and Malam Jabba under 'Pearl Continental', besides one franchised hotel located at Gwadar. The Company also grants franchise to use its trade mark and name "Pearl Continental". Further, the company is in process of constructing hotels in Multan and Mirpur, Azad Jammu & Kashmir.

Ownership

Ownership Structure Majority stake in Pakistan Services Limited is owned & controlled by foreign companies. 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 has considerable expertise in hospitality sector.

Financial Strength 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.

Governance

Board Structure The Company's Board comprises ten members. Three are Executive Directors, four are Non-Executive Directors and three are Independent Directors.

Members' Profile Mr. Sadruddin Hashwani, Chairman of the board, possesses more than four decades of experience in the hospitality sector. They include professional accountants and experienced individuals from the hospitality industry.

Board Effectiveness The board has formed four committees namely; i) Audit Committee ii) Human Resource Committee iii) Nomination Committee and iv) Risk management Committee to comply with the corporate governance code. During the FY24, three board meetings were held in which the 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, 2023.

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. Bastien Paul Emile Blanc with more than two decades of experience in the hospitality industry, is the new CEO of the Company, who replaced Mr. Murtaza Hashwani. Other Board members also havewell-diversified and extensive profiles. Mr. Tahir Mahmood (CFO), is an experienced professional having associated with Hashoo group for the last 13 years. Other members of the management tier are all seasoned professionals with relevant 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 an integrated, cloud-based, management system designed specifically for the hospitality industry.

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, the progression of China Pakistan Economic Corridor (CPEC) boosted the industry. The luxury hotel 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, operating under the brand 'Pear Continental', is the leading 5-star brand in the country with 1,702 rooms, followed by Serena Hotels, Avari Hotels, and Marriottt 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 9MFY24, the Company posted revenues worth PKR 11,388mln, FY23 PKR 13,262mln (FY22: PKR 11,988mln). However, improvement in occupancy rates is expected in future.

Margins During 9MFY24, the Company witnessed an increase in gross profit margin, which increased to ~42.3%, FY23 : ~37.9% (FY22: 41.4%) The Company recorded a net profit of PKR ~732mln, though during FY23, Company recorded a net loss of PKR -218mln (FY22: Profit of PKR 609mln).

Sustainability Management was optimistic regarding sizeable repayment of long-term debt through sale of its fixed assets, mainly properties. One of the properties has been disposed of during the review period and some transactions are yet to be materialized due to current macroeconomic challenges.

Financial Risk

Working Capital During 9MFY24, the Company was not able to maintain a strong position on its working capital management with a net working capital cycle at -10days and -8days respectively (FY22: -8days). Materialization of initiatives to improve cashflows is critical for the Company, in order to eliminate asset-liability mismatch.

Coverages During 9MFY24, Company's free cashflows from operations reached to PKR 3,224mln, FY23 PKR ~2,047 (FY22: 3,072mln). The interest coverage ratio reached to 1.9x in 9MFY24, FY23 1.2x (FY22: 2.6x).

Capitalization Total borrowings during 9MFY24 stood at PKR 10,922mln, FY23 clocked in at PKR 14,053mln (FY22: 15,887mln). Leveraging ratio during 9MFY24 recorded at ~20% , FY23 clocked in at ~24% (FY22: ~26%).

PACRA

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

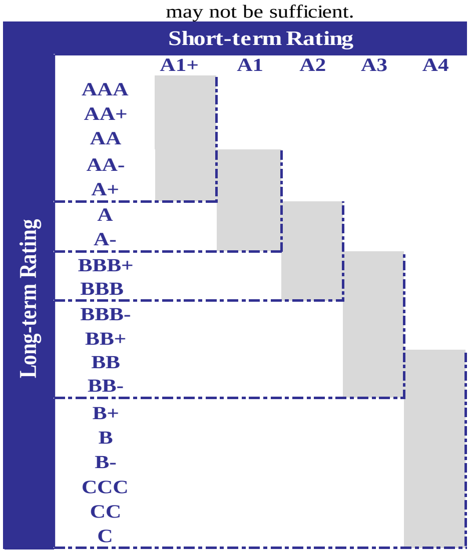
Pakistan Services Limited	Mar-24	Jun-23	Jun-22	Jun-21
Hospitality	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	48,985	47,853	51,090	41,004
2 Investments	1,248	1,216	1,833	1,288
3 Related Party Exposure	1,769	1,770	2,913	4,374
4 Current Assets	10,302	13,902	10,224	8,363
a Inventories	*331*	*306*	*147*	*89*
b Trade Receivables	*1,004*	*940*	*781*	*405*
5 Total Assets	62,303	64,742	66,060	55,029
6 Current Liabilities	4,305	4,566	4,105	2,532
a Trade Payables	*1,689*	*1,712*	*1,042*	*886*
7 Borrowings	10,922	14,053	15,887	17,227
8 Related Party Exposure	159	65	24	36
9 Non-Current Liabilities	1,246	1,119	890	725
10 Net Assets	45,672	44,939	45,154	34,510
11 Shareholders' Equity	45,672	44,939	45,154	34,510
B INCOME STATEMENT				
1 Sales	11,388	13,262	11,988	6,941
a Cost of Good Sold	*(6,569)*	*(8,235)*	*(7,026)*	*(4,745)*
2 Gross Profit	4,819	5,027	4,962	2,196
a Operating Expenses	(2,928)	(3,850)	(2,899)	(1,988)
3 Operating Profit	1,892	1,177	2,064	208
a Non Operating Income or (Expense)	*783*	*816*	*(58)*	*440*
4 Profit or (Loss) before Interest and Tax	2,674	1,992	2,005	649
a Total Finance Cost	*(1,730)*	*(1,925)*	*(1,378)*	*(1,226)*
b Taxation	*(211)*	*(286)*	*(18)*	*181*
6 Net Income Or (Loss)	732	(218)	609	(396)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*3,224*	*2,047*	*3,072*	*1,342*
b Net Cash from Operating Activities before Working Capital Changes	*264*	*(397)*	*877*	*857*
c Changes in Working Capital	*352*	*494*	*(90)*	*(368)*
1 Net Cash provided by Operating Activities	616	97	786	489
2 Net Cash (Used in) or Available From Investing Activities	1,940	1,756	427	67
3 Net Cash (Used in) or Available From Financing Activities	(2,785)	(1,243)	(707)	(622)
4 Net Cash generated or (Used) during the period	(229)	610	507	(66)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	14.5%	10.6%	72.7%	-14.6%
b Gross Profit Margin	42.3%	37.9%	41.4%	31.6%
c Net Profit Margin	6.4%	-1.6%	5.1%	-5.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	31.4%	19.2%	24.9%	14.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	2.2%	-0.5%	1.5%	-1.1%
2 Working Capital Management				
a Gross Working Capital (Average Days)	31	30	22	20
b Net Working Capital (Average Days)	-10	-8	-8	-28
c Current Ratio (Current Assets / Current Liabilities)	2.4	3.0	2.5	3.3
3 Coverages				
a EBITDA / Finance Cost	1.6	1.5	2.8	1.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.4	0.2	0.5	0.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.7	43.8	7.3	47.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	19.5%	23.9%	26.1%	33.3%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Entity Average Borrowing Rate	16.7%	11.8%	7.2%	6.0%

Credit Rating

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 Rating	
Scale	**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.

Short-term Rating	
Scale	**Definition**
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
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