

September 30, 2022

Varun Hospitality Private Limited: Ratings reaffirmed; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term – Fund Based/Cash Credit	3.50	3.20	[ICRA]BBB- reaffirmed; Outlook revised to Stable from Negative
Long term – Fund Based/Term Loans	233.39	233.69	[ICRA]BBB- reaffirmed; Outlook revised to Stable from Negative
Long Term/Short Term – Non-Fund Based	8.00	8.00	[ICRA]BBB-/ [ICRA]A3 reaffirmed; Outlook revised to Stable from Negative
Total	244.89	244.89	

*Instrument details are provided in Annexure-I

Rationale

The revision of outlook considers the expected healthy improvement in the operational performance of Varun Hospitality Private Limited (VHPL) in FY2023, with strong occupancies and improved average room rent (ARR) across its properties. The company is expected to record 15-20% revenue growth in FY2023, with revenues expected to exceed the pre-Covid levels; the margins are also expected to remain healthy between 37-40%. Moreover, VHPL's tie-ups with multiple corporates has also supported improvement in occupancy. The recovery in the company's performance in FY2022 was better than expected with the resumption of business and leisure travel in H2 FY2022. Moreover, VHPL's tie-ups with multiple corporates have supported the improvement in occupancy. The ratings also consider the diversified operational profile of VHPL, with four hotel properties having 575 rooms in Vishakhapatnam and Vijayawada in Andhra Pradesh, and fixed rental income from Varun INOX (mall-cum multiplex) in Vishakhapatnam. ICRA notes the favourable locations of the hotels in Vishakhapatnam and Vijayawada, supporting occupancy of the properties. The ratings consider the company's tie-ups with Accor Hotels, France, for its 'Novotel' brand and Indian Hotels Company Limited (IHCL) for the 'Taj Gateway' brand, resulting in benefits from the marketing and advertising networks of these management companies.

The ratings are, however, constrained by VHPL's leveraged capital structure with high debt and moderate net worth. Moreover, the company has significant debt-funded capex plans over the medium term (over five years starting from FY2024), which are expected to impact the capital structure. ICRA notes that the funding and cost estimates are yet to be finalised and this would be a key monitorable. ICRA also notes that the hotel industry is cyclical in nature and remains vulnerable to any general economic slowdown as well as external threats. Akin to its counterparts, VHPL's revenue remains susceptible to exogenous shocks, such as natural calamities and economic/political instability. The ratings are also constrained by the support extended by VHPL to its Group entity, Varun Finance (VF) (which has been merged with Varun Motors Private Limited w.e.f. July 1, 2022); VHPL had Rs. 119.7 crore of deposits in VF as on March 31, 2022, to support VF's working capital requirements. ICRA notes that timely receipt of these funds from the Group entity remains critical to fund its capital expenditure; any increased debt funding of capex because of delays in receipt of funds from VMPL (which took over VF's operations), would impact VHPL's credit profile and will be a key monitorable.

Key rating drivers and their description

Credit strengths

Diversified operational profile – The company operates four hotel properties with 575 rooms, which includes two hotels and one resort in Visakhapatnam and one hotel in Vijayawada, Andhra Pradesh. Apart from the hotels, VHPL has an entertainment centre, Varun INOX, in Vishakhapatnam, Andhra Pradesh, from which it gets a fixed rental income. The company's properties are in the prime locations of Visakhapatnam and Vijayawada, ensuring healthy demand and robust occupancy.

Management contract with Accor Group and Indian Hotels – The company has a management contract with the Accor Group for the ‘Novotel’ brand and IHCL for the ‘Gateway’ brand, resulting in benefits from the marketing and advertising networks of these management companies. Accor Hotels is among the world’s largest names involved in the tourism and hospitality industries, with its presence across 110 countries. It has over 40 years of experience in the hospitality industry, with a network of more than 5,300 hotels across the globe. IHCL, part of the Tata Group, is India’s largest hospitality company. The hotel and its subsidiaries owned/operated 167 hotels, with 19,568 rooms across four continents, 12 countries and over 100 cities.

Healthy improvement in occupancies and ARR across properties in FY2022 and 5M FY2023 – The operational performance of VHPL improved significantly in FY2022 and further in 5M FY2023, with healthy improvement in occupancies and ARR across the four properties, which led to significant revenue growth. The average occupancy improved to 66% in FY2022 and further to 74% in 5M FY2023 from 42% in FY2021, indicating healthy recovery from the Covid-19 pandemic slump in FY2021.

Credit challenges

Leveraged capital structure – The company’s capital structure is leveraged on account of high debt levels. Its total debt increased to Rs. 268.7 crore as on March 31, 2022, however the net worth improved in FY2022 owing to healthy cash accruals, which lead to improvement in gearing to 3.3 times as on March 31, 2022, from 4.4 times as on March 31, 2021. The capital structure is expected to moderate in the medium term, with significant infusion of debt to fund the upcoming capital expenditure for new hotels which will also impact the profitability. Hence, the debt coverage metrics and capital structure are expected to moderate.

Sizeable medium-term debt repayments – The company has sizeable debt repayments of Rs. 46.2 crore in FY2023 and Rs. 47.3 crore in FY2024. However, the expected cash flows would be comfortable to service the obligations. The debt repayments are expected to increase from FY2025, as the company plans to avail significant debt to fund the capital expenditure towards new hotels.

Sizeable support extended to Group entity – VHPL has extended sizeable support to Varun Finance (VF) [now merged with Varun Motors Private Limited (VMPL)] in the form of deposits of Rs. 119.7 crore as on March 31, 2022, which increased to Rs. 165.0 crore as on August 31, 2022. Timely receipt of these funds from the Group entity remains critical to fund its capital expenditure; any increased debt funding of capex because of delays in receipt of funds from VMPL (which took over VF’s operations), would impact VHPL’s credit profile and will be a key monitorable.

Cyclical industry, vulnerable to general economic slowdown and external threats – The hospitality industry is exposed to economic cycles, given that a significant part of the demand arises from business travellers, which impact the revenue and profitability of the players. Akin to its counterparts, VHPL’s revenue remains susceptible to exogenous shocks such as natural calamities and economic/political instability.

Liquidity position: Adequate

VHPL’s liquidity position is expected to remain **adequate** in the near term, given the expected retained cash flows of about Rs. 55 crore for FY2023 and undrawn working capital limits of Rs. 4.4 crore as on August 31, 2022, against the repayment obligations of Rs. 40.8 crore over the next twelve months. It does not have any major capex plans over the next twelve months, and its retained cash flows and cash balances would be adequate to meet its debt obligations.

Rating sensitivities

Positive factors: ICRA could upgrade the ratings of VHPL, if there is any sustained improvement in scale of operations, while maintaining profitability and healthy accruals, leading to improvement in the overall credit metrics. A specific credit metric for an upgrade is if DSCR is more than 1.5 times, on a sustained basis.

Negative factors: The ratings of VHPL may be downgraded, if there is any sustained material decline in the scale of the company, impacting its profitability and other debt protection metrics. The ratings could also be impacted if there is any increase in debt funding for the capex because of delay in receipt of funds from Varun Finance or, if liquidity is impacted because of support extended to Group entities. A specific credit metric for a downgrade is if DSCR is less than 1.0 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating methodology - Hotels
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on standalone financial profile of the company

About the company

VHPL operates three five-star hotels and a resort with 575 rooms and an entertainment centre. In Vishakhapatnam, Andhra Pradesh, the company has two five-star hotels – Novotel Varun Beach, which has 225 rooms including 10 suites, and The Taj Gateway Hotel with 95 rooms. The company has an entertainment centre, Varun INOX, which is a six-screen multiplex with a seating capacity of 1,166, along with a shopping area and mini restaurants. It has a resort with 28 rooms in Bheemili (32 km from Novotel Varun Beach), which is operated as an extension to the Vishakhapatnam Novotel hotel. The company constructed a five-star hotel with 227 rooms in Vijayawada, which commenced operations in December 2018, under the 'Novotel' brand.

Key financial indicators

	FY2021	FY2022*
Operating income	100.0	168.6
PAT	(14.9)	29.2
OPBDIT/OI	35.6%	41.8%
PAT/OI	(14.9%)	17.3%
Total outside liabilities/Tangible net worth (times)	4.7	3.4
Total debt/OPBDIT (times)	6.2	3.8
Interest coverage (times)	1.8	3.3

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; Provisionals FY2022*

Note: Amount in Rs. crore; All calculations are as per ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2023)		Chronology of rating history for the past 3 years				
		Amount rated	Amount O/s as of Aug 31, 2022	Date & rating in FY2023	FY2022	FY2021	FY2020	
				Sep 30, 2022	Jun 09, 2021	Apr 20, 2020	Mar 19, 2020	Apr 04, 2019
1 Cash credit	Long term	3.20	-	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
2 Term loans	Long term	233.69	233.69	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
3 Bank guarantee	Long term/ Short term	8.00	-	[ICRA]BBB-(Stable) /[ICRA]A3	[ICRA]BBB-(Negative) /[ICRA]A3	[ICRA]BBB-(Negative) /[ICRA]A3	[ICRA]BBB-(Stable) /[ICRA]A3	[ICRA]BBB-(Stable) /[ICRA]A3
4 Unallocated	Long term	-	-	-	-	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)

Amounts in Rs. Crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund based/Term loans	Simple
Long term – Fund based/Cash credit	Simple
Long term / Short term – Non fund based	Very simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans	FY2018	NA	FY2028	233.69	[ICRA]BBB-(Stable)
NA	Cash credit	NA	NA	NA	3.20	[ICRA]BBB-(Stable)
NA	Unallocated limits	NA	NA	NA	8.00	[ICRA]BBB-(Stable)/[ICRA]A3

Source: Company

Annexure II: List of entities considered for consolidated analysis: NA

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