August 30, 2019

Sayaji Hotels Limited: Ratings reaffirmed at [ICRA]BBB-; rating continues to be on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-Term Loans	68.18	68.95	[ICRA]BBB- & reaffirmed; on watch with developing implications
Fund-based- Working Capital Facilities	6.75	8.75	[ICRA]BBB- & reaffirmed; on watch with developing implications
Non-fund Based-Working Capital Facilities	3.92	0.5	[ICRA]BBB- &reaffirmed; on watch with developing implications
Long-Term Unallocated Limits	15.03	15.68	[ICRA]BBB- reaffirmed; on watch with developing implications
Total	**93.88**	**93.88**	

Instrument details are provided in Annexure-1

Rationale

The ratings assigned to the bank facilities of Sayaji Hotels Limited (SHL) continue to be on watch with developing implications, given that the proposed scheme of arrangement, which sought to realign the businesses at present under SHL and its promoters, is still awaiting final concurrence from the National Company Law Tribunal (NCLT)[1]. A significant proportion of revenue generating assets (viz. ~60% of standalone revenues of SHL in FY2019), along with associated debt and other obligations, are proposed to be demerged from SHL and amalgamated with two separate entities (viz. Sayaji Hotels (Pune) Limited (SHPL), Sayaji Hotels Management Limited (SHML)). This would result a significant change in the credit profile of the resulting company. While the management has indicated that covenants will be put in place to ensure adequate security cover for the existing lenders (through cross-collateralisation of assets, corporate guarantee among others) and timely funding of repayment obligations across the three resulting entities, ICRA would continue to monitor the developments. ICRA will take appropriate rating action once the scheme is in advanced stages of implementation, post analysing the impact on SHL's credit profile.

The reaffirmation of ratings favourably factors in the steady operating and financial performance, despite two new hotels viz. Sayaji Raipur and Vadodara, in early stages of ramp-up and Effotel Vadodara being closed for renovations-cum-expansion in H1 FY2019. On consolidated level, the company reported a 13% and 20% YoY growth in operating income (OI) and operational profits, respectively, in FY2019. Nonetheless, the performance of its key Indore property was impacted due to the Madhya Pradesh State elections and model code of conduct implemented in Q3 FY2019, coupled with increasing competition from new inventory in the micro-market. Moreover, a shorter wedding season impacted the food and beverages (F&B) business. ICRA continues to take cognisance of SHL's investments in Barbeque

[1]The scheme has been approved by company's shareholders and creditors as per company's disclosure dated August 16, 2019 on Bombay Stock Exchange with lenders and stock exchanges also having given their consent (as per management discussions).

Nation Hospitality Limited (BNHL rated [ICRA] A+(Stable)/[ICRA] A1+), whose planned public listing (albeit delayed from last year) would significantly improve SHL's financial flexibility. The ratings continue to factor in the extensive experience of the company's promoters and their demonstrated track record of funding support along with its geographically diversified portfolio, renowned F&B and banqueting segment (offering higher margin business). The ratings draw comfort from its established customer base and brand recall of 'Sayaji' and "Effotel" in the operative micro-markets. ICRA notes the increase in the company's portfolio in FY2020 with the launch of Effotel Gurgaon (50 keys) and Sayaji Rajkot (75+ keys) under management contract. The same has been in line with the management's stated strategy of leveraging its brands and expanding presence through an asset-light model. While a moderately favourable outlook for the hospitality industry is a positive for SHL, the benefits from this managed portfolio (now comprising three properties and over 250 rooms) are expected to accrue over medium term as the properties ramp up.

The ratings, however, remain constrained by the company's modest return on capital employed and debt coverage indicators. This is due to moderating profitability from its Indore property, coupled with high overheads associated with nascent properties (Sayaji Raipur and Vadodara and Effotel Vaodara, post-renovations) and regular debt-funded capex incurred towards capacity expansion and/or renovations. Incremental unsecured loans from promoters in FY2019, purchase of non-core assets from SHL (Aries Hotels investment) and proposed deferment of preference share redemption due in FY2020[2] evidence promoters' commitment to the business. However, the high cost of this debt, coupled with high repayment obligations over the next three years are expected to inhibit any improvement in the company's debt metrics. In addition, the timely and seamless implementation of the proposed restructuring scheme and resultant benefits still remain to be seen. Inherent cyclicality and seasonality in the hospitality industry exposes its revenues to risks associated with economic slowdown and exogenous shocks, although the same is partially mitigated by SHL's geographically diversified portfolio.

Going forward, the company's ability to stabilise its new inventory, improve the profitability of its mature operational properties (especially Indore), plan the pace (and manner) of its future renovation and expansion plans so as to limit the impact on its business and financial risk profile, will remain the key rating sensitivities. SHL's ability to amicably resolve the legal dispute with Indore Development Authority (IDA) for its flagship Indore property, over the alleged violation of lease terms by the company, remains a key monitorable. Any adverse verdict in the matter can severely impact SHL's credit profile and remains an event risk.

Outlook: Not applicable

Key rating drivers

Credit strengths

Steady operational performance in FY2019 despite competition – SHL registered a steady portfolio revPAR in FY2019, driven by healthy ramp up of the newly-added Sayaji Vadodara and Raipur properties. The growth was, however, moderated due to increased competition faced by its core Indore property and closure of Effotel-Vadodara for

[2] *Preference Shares of Rs. 20.5 crore (debt and equity component) as of March 31, 2019 have been subscribed to by the promoter family and were due for redemption, inclusive of dividend payments of 5 years in arrears, in FY2020. While announcing its Q1 FY2020 results, the company informed regarding Board approval for deferment of this redemption by 5 years.*

renovation-cum-expansion in H1 FY2019. Going forward, ICRA expects the operating metrics to continue improving at a modest pace in line with the expectation of limited supply and stable demand. However, its ability to navigate the increasing competition in Indore remains crucial.

Experienced promoters with demonstrated record of funding support – SHL is promoted by the Dhanani family, which has been a part of the hospitality industry for over 30 years. The promoter family demonstrated a track record of providing funding support to the company for its periodic capex and short-term funding mismatches. As of FY2019 end, SHL (standalone) had outstanding unsecured promoter loans of around Rs. 17.2 crore, in addition to preference share capital of Rs. 20.5 crore. Purchase of non-core investments of SHL by the promoters, like Aries Hotels (land parcel), is likely to support cash flows in the current fiscal. All these are indicative of the promoters' commitment to its business and ICRA expects this need-based support to continue.

Healthy geographical diversification; strong brand recognition of Sayaji in the operative micro-markets – Under its in-house brand, Sayaji and Effotel, the company has established itself as a reputed hotel chain primarily in the tier-II and tier-III cities. With nearly 1,200+ rooms across ten operational properties in eight cities, the brands Sayaji and Effotel are rapidly expanding their market presence leading to healthy geographical diversification. It has recently launched another brand, Enrise, as a mid-scale segment operating in Indore and plans to expand this brand in other cities, where it already has an established presence. ICRA expects that this would further aid in increased brand visibility and rapid expansion of SHL in diversified markets through an asset-light model.

Portfolio expansion through management contracts limit capex requirement and project implementation risk – Over the past two to three years, the management has shifted its focus from building capex-intensive properties to follow an asset-light model of expansion, through leasing of properties and management contracts. The last two Sayaji properties (land and building) – Raipur and Vadodara – have been acquired on lease, while it has expanded its portfolio of properties under management contract with the launch of Effotel-Gurugram and Sayaji-Rajkot in YTD FY2020. This would help the company conserve its funds, while allowing the scope for quick scale-up of revenues and profitability.

Sizeable investments in profit generating BNHL offers potential for leverage and financial flexibility – SHL owns a chain of 119 restaurants (as of December 2018) through its 45.7%-owned associate, BHNL. Having received a SEBI approval, BNHL was expected to go public in FY2018, however, the plan was postponed. Going forward, the listing of its investee company would lead to enhanced financial flexibility for SHL, as it would have the option to monetise this to reduce or pay off its debts.

Credit challenges

Subdued profitability and returns on capital employed – SHL generates over 50% of EBITDA (FY2019) from its properties located in Indore. In FY2019, both Sayaji and Effotel Indore registered a 2-3.5% YoY decline in profitability margins. This was primarily owing to competition from incremental inventory (JW Marriott, other unorganised sector players) and banqueting spaces in the micro-market. Further, with incremental debt taken for Raipur and Vadodara (renovations), the properties are yet to start contributing meaningfully to profits. The return on capital employed remained modest (despite YoY improvement). Over the medium term, ICRA expects the profitability margins to remain constrained in 17-18% range. Anticipated benefits from expansion of portfolio under management contract and pace of flow through to profitability remain a key monitorable.

Moderate debt coverage indicators with sizeable medium-term repayment – The company has large debt repayment obligation worth approximately Rs. 68 crore over the next three years. This is expected to result in moderation in its debt coverage metrics with DSCR ranging between 0.9 times and 1.2 times (FY2020-FY2022). Nonetheless, ICRA expects stable cash flows from operations, coupled with sales proceeds from divestment of Malwa Hospitality stake, to ensure timely repayments. With scheduled debt reduction and increasing net worth (owing to share of profit contributions from BNHL), the consolidated gearing is likely to improve substantially over the medium term.

Timely and effective implementation of proposed restructuring scheme – The proposed scheme of arrangement, which seeks to realign the businesses at present under SHL and its promoters, is yet to receive the requisite regulatory approvals. The timely and seamless implementation of the scheme and resultant benefits remain a key monitorable.

Vulnerability of revenues to inherent industry cyclicality, economic cycles and exogenous events – The operating performance of the properties remains vulnerable to seasonal industry, general economic cycles and exogenous factors (geopolitical crisis, terrorist attacks, disease outbreaks etc). Nonetheless, since the impact varies across markets, the risk to revenues is partially mitigated by SHL's geographically diversified portfolio.

Liquidity position

ICRA expects SHL's liquidity to remain adequate over the medium term benefiting from healthy cash flow generation anticipated in FY2020, driven by the ramp up of the newly launched Vadodara and Raipur properties. As of end-FY2019, SHL had cash and liquid investments of Rs. 5 crore and undrawn working capital limits of around Rs. 3 crore. In YTD FY2020, the company reportedly received sales consideration of Rs. 5.7 crore from stake sale in Aries Hotels. Further, stake sale from Malwa Hospitality (51% subsidiary) is expected to yield Rs. 6.89 crore by the end of FY2020. The available liquidity would remain enough to cover its upcoming long-term debt repayments of Rs. 20 crore (due in FY2020) and modest capex requirements. The repayment of Rs. 20-crore unsecured loan from Mr. Nakoda (payable towards cancellation of agreement for land at Indore hotel) is due in FY2021. However, with no major debt-funded capacity expansion or new project plans, the cash accruals are expected to remain enough to cater to these repayment obligations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Hotel Industry Consolidation and Rating Approach
Parent/Group Support	None
Consolidation / Standalone	The rating is based on consolidated financial statements of the issuer. The consolidated entities are listed under Annexure-2.

About the company

Incorporated in 1982, SHL commenced operations of its first hotel property at Vadodara in 1990. As on date, it has a portfolio of 1200+ rooms across ten hotel properties located in Vadodara (two properties), Indore (two properties), Pune, Bhopal, Raipur, Kolhapur, Gurgaon and Rajkot. The properties are operated under its in-house brands - Sayaji and Effotel. It has a banquet hall property, Amber Garden, in Indore. The Effotel Indore hotel is owned through its 51.67%

owned subsidiary Malwa Hospitality Private Limited (MHPL), while the properties at Kolhapur, Gurgaon and Rajkot (cumulative room inventory of 250 keys) are under management contract.

The company has been listed on BSE since 1992. It also owns a chain of 119 restaurants (as of December 2018) through its 45.73% owned associate - BNHL, which is owned through SHL's wholly owned subsidiary Sayaji Housekeeping Services Limited). SHL is promoted by the Indore-based Dhanani family, which directly held 74.9% stake as of June 30, 2019.

Key financial indicators (Audited)

Consolidated	FY2018	FY2019*
Operating Income (Rs. crore)	198.8	244.4
PAT (Rs. crore)	(5.8)	(0.3)
OPBDIT/OI (%)	16.0%	17.0%
RoCE (%)	4.7%	7.1%
Total Debt/TNW (times)	1.0	1.0
Total Debt/OPBDIT (times)	4.3	3.5
Interest Coverage (times)	2.1	2.2

*Source: Annual reports; ICRA research; *Limited audited results*
PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding Mar 2019 (Rs. crore)	Date & Rating Aug-19^	Date & Rating in FY2019 Sep-18	Date & Rating in FY2018 Feb-18	Date & Rating in FY2018 Dec-17	Date & Rating in FY2017 Jan-17
1	Long term - Term Loans	Long Term	68.95	63.09	**[ICRA]BBB- &**	**[ICRA]BBB- &**	**[ICRA]BBB- (stable)**	**[ICRA]BBB- @; on watch with negative implications**	**[ICRA]BBB- (stable)**
2	Long term- Cash Credit Facilities	Long Term	8.75	NA	**[ICRA]BBB- &**	**[ICRA]BBB- &**	**[ICRA]BBB- (stable)**	**[ICRA]BBB- @**	**[ICRA]BBB- (stable)**
3	Long term - Non-fund-based facilities	Long Term	0.5	NA	**[ICRA]BBB- &**	**[ICRA]BBB- &**	**[ICRA]BBB- (stable)**	**[ICRA]BBB- @**	**[ICRA]BBB- (stable)**
4	Unallocated	Long term	15.68	NA	**[ICRA]BBB- &**	**[ICRA]BBB- &**	**[ICRA]BBB- (stable)**	**[ICRA]BBB- @**	**[ICRA]BBB- (stable)**

^ PR for delay in periodic surveillance published in May 2019

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Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website click here

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Jan-15	NA	Jul-21	7.10	[ICRA]BBB- &
NA	Term Loan 2	Sep-16	NA	Mar-22	12.37	[ICRA]BBB- &
NA	Term Loan 3	Sep-16	NA	Mar-21	1.43	[ICRA]BBB- &
NA	Term Loan 4	Jan-17	NA	Jan-25	21.05	[ICRA]BBB- &
NA	Term Loan 5	Oct-16	NA	Oct-21	7.43	[ICRA]BBB- &
NA	Term Loan 6	Oct-16	NA	Sep-23	5.72	[ICRA]BBB- &
NA	Term Loan 7	Oct-16	NA	Sep-20	2.71	[ICRA]BBB- &
NA	Term Loan 8	Mar-18	NA	Jul-26	8.70	[ICRA]BBB- &
NA	Term Loan 9	Mar-18	NA	Sep-26	2.44	[ICRA]BBB- &
NA	Cash Credit	Mar-18	NA	NA	8.75	[ICRA]BBB- &
NA	Bank Guarantee	Mar-18	NA	NA	0.50	[ICRA]BBB- &
NA	Unallocated Limits	NA	NA	NA	15.68	[ICRA]BBB- &

Source: Company

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Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Sayaji Hotels Limited	100.00%	Full Consolidation
Malwa Hospitality Private Limited	51.67%	Full Consolidation
Sayaji Housekeeping Services Limited	100.00%	Full Consolidation
Aries Hotels Private Limited	52.37%	Full Consolidation
Barbeque Nations Hospitality Limited	45.73%	Equity Method
Sayaji Hotels Management Limited	100.00%	Full Consolidation
Sayaji Hotels (Pune) Limited	100.00%	Full Consolidation
Sayaji Hotels (Vadodara) Limited	100.00%	Full Consolidation

Source: SHL's Annual report FY2018 and company discussion

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