

December 18, 2023

## Varun Hospitality Private Limited: Ratings upgraded to [ICRA]BBB(Stable)/[ICRA]A3+

### Summary of rating action

| Instrument*                            | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action  |
|--|--------------------------------------|-------------------------------------|--|
| Long-term – Fund-based/ Cash Credit    | 3.50                                 | 3.50                                | [ICRA]BBB (Stable); upgraded from [ICRA]BBB- (Stable)                    |
| Long-term – Fund-based/ Term Loans     | 233.39                               | 194.51                              | [ICRA]BBB (Stable); upgraded from [ICRA]BBB- (Stable)                    |
| Long-term/ Short-term – Non-fund Based | 8.00                                 | 8.00                                | [ICRA]BBB(Stable)/[ICRA]A3+; upgraded from [ICRA]BBB- (Stable)/ [ICRA]A3 |
| Long-term – Unallocated                | -                                    | 38.88                               | [ICRA]BBB (Stable); upgraded from [ICRA]BBB- (Stable)                    |
| <b>Total</b>                           | <b>244.89</b>                        | <b>244.89</b>                       |  |

\*Instrument details are provided in Annexure-I

### Rationale

The ratings upgrade factors in the healthy demand prospects for the hospitality industry, which along with favourable locations of Varun Hospitality Private Limited's (VHPL) properties and its tie-ups with reputed hotel chains are expected to result in improved operational metrics and sustained improvement in the company's earnings and debt metrics. Moreover, the company's performance in FY2023 was better than anticipated with strong occupancy of 71% and 18% growth in Average Room Rate (ARR)s, on the back of increase in business and leisure travel from pent up demand after the Covid-19 pandemic. This resulted in 23.0% revenue growth and 280 bps improvement in operating margins. While the occupancy moderated to 63% in 8M FY2024 with correction in pent-up demand, ARR's continued to remain high. The company recorded total operating income of Rs. 137.7 crore in 8M FY2024.

VHPL's revenue growth is expected to remain muted in FY2024 given the moderation in occupancy; however, revenues will be significantly higher than pre-Covid levels. The OPM improved to 43.0% in FY2023 with higher occupancy and ARR. While operating margin is expected to moderate marginally, it is expected to remain healthy at ~40% in the near term.

VHPL's tie-ups with multiple corporates support its occupancy. The ratings also consider the diversified operational profile of VHPL with four hotel properties having 575 rooms in Visakhapatnam and Vijayawada in Andhra Pradesh, and fixed rental income from Varun INOX (mall-cum multiplex) in Visakhapatnam. ICRA notes the favourable locations of the hotels in Visakhapatnam 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 coverage indicators are also expected to remain moderate in the near term and improve sequentially.

The ratings are, however, constrained by VHPL's moderate capital structure with high debt and moderate net worth. Moreover, the company has significant debt-funded capital expenditure (capex) plans over the medium term (over five years starting from FY2024), which are expected to impact the capital structure. 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 peers, 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). VHPL extended Rs. 129.7 crore of loans and advances to VF, as on March 31, 2023 (Rs. 113.0 crore as on November 20, 2023). ICRA notes that timely receipt of these funds from the Group entity remains critical to fund its capex, going forward. Any increased debt funding of capex in the absence of receipt of funds from VF would impact VHPL's credit profile and will be a key monitorable.

The Stable outlook on VHPL's rating reflects ICRA's opinion that the company will continue to maintain its financial profile benefitting from strong demand for travel and tourism across the country, supporting healthy occupancies and improved ARR.

## 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 Visakhapatnam, from which it receives 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 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 own/operate 167 hotels, with 19,568 rooms across four continents, 12 countries and over 100 cities.

**Favourable demand outlook; healthy improvement in occupancies and ARR across properties in the past two years** – The healthy demand outlook for hotels is likely to support revenues and accruals for VHPL in the next 6-12 months. The operational performance of VHPL improved significantly in FY2023, with healthy improvement in occupancies and ARR across the four properties, which led to significant revenue growth. The average occupancy improved to 71% in FY2023. However, the occupancy moderated to 63% in 8M FY2024 owing to moderation in pent-up demand; while ARR continued to remain healthy in 8M FY2024 as well. Although the company's revenue is expected to moderate marginally in FY2024 with moderation in occupancy, revenues are expected to be significantly higher than pre-Covid levels.

### Credit challenges

**Leveraged capital structure** – The company's capital structure is leveraged on account of high debt levels. However, the company's gearing improved to 2.2 times as on March 31, 2023, from 3.9 times as on March 31, 2022, owing to improvement in the net worth (VHPL reported net profit of Rs. 34.2 crore in FY2023 due to healthy OPBITDA). The company has sizeable capex plans to establish a 384-room hotel in Devanahalli, Bangalore, at a total project cost of Rs. 290-300.0 crore. Despite additional debt expected over FY2025 to FY2027, the gearing is expected to be at 1.0-1.5 times, going forward, given healthy expected accruals with high profitability. The coverage indicators are also expected to remain moderate in the near term and improve sequentially.

**Significant capex plans and sizeable medium-term debt repayments** – The company has sizeable debt repayments of Rs. 50-55.0 crore in the next 12 months. However, the expected cash flows would be comfortable to service the obligations. Debt levels are expected to increase from FY2025, as the company plans to avail significant debt to fund the capex towards the new hotel's construction. The company has sizeable capex plans to establish a new hotel of about 380 rooms in Bangalore, for which it has already leased land and has started excavation works from August 2023. The estimated cost of this hotel is Rs. 290-300 crore, which is expected to be incurred over four years starting from FY2024. The capex would be funded by 60% debt and 40% internal accruals. The company is in discussions with the Accor Group (for 200 beds of the capacity under the Novotel brand and 180 beds under the IBIS brand) for this proposed property.

**Sizeable support extended to Group entity** – VHPL has extended sizeable support to VF with loans and advances of Rs. 129.7 crore, as on March 31, 2023, which decreased to ~Rs. 113.0 crore as of November 20, 2023. Timely receipt of these funds from VF remains critical to fund its capex, going forward. Any increased debt funding of capex in the absence of receipt of funds from VF 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 industry players. Akin to its peers, 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. 60-70.0 crore for the next 12 months and undrawn working capital limits of Rs. 1.6 crore as on November 30, 2023, against repayment obligations of ~Rs. 51.0 crore over the next 12 months. The company has capex plans of about Rs. 60-70.0 crore over the next 12 months to be funded through a mix of debt and internal accruals.

### Rating sensitivities

**Positive factors** – ICRA could upgrade the ratings of VHPL if sustained improvement in its scale of operations, while maintaining its profitability and healthy accruals, leads to improvement in the overall credit metrics.

**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 material increase in debt-funded capex, or if delay in receipt of funds from VF, or support extended to Group entities impacts its liquidity position. A specific credit metric that may lead to a rating downgrade is if DSCR is less than 1.2 times, on a sustained basis.

### Analytical approach

| Analytical Approach             | Comments   |
|---------------------------------|--|
| Applicable rating methodologies | <a href="#">Corporate Credit Rating Methodology</a><br><a href="#">Rating methodology - Hotels</a> |
| 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 Visakhapatnam, Andhra Pradesh, the company has two five-star hotels—Novotel Varun Beach with 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. VHPL also has a resort with 28 rooms in Bheemili (32 km from Novotel Varun Beach), which is operated as an extension to the Visakhapatnam Novotel hotel. The company constructed a five-star hotel with 227 rooms in Vijayawada, which commenced operations from December 2018, under the 'Novotel' brand.

### Key financial indicators (audited)

|  | FY2022 | FY2023 |
|--|--------|--------|
| Operating income                                     | 166.5  | 204.9  |
| PAT  | 17.1   | 34.2   |
| OPBDIT/OI  | 40.2%  | 43.0%  |
| PAT/OI   | 10.3%  | 16.7%  |
| Total outside liabilities/Tangible net worth (times) | 4.3    | 2.6    |
| Total debt/OPBDIT (times)                            | 4.1    | 2.6    |
| Interest coverage (times)                            | 3.3    | 4.0    |

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

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

### Rating history for past three years

| Instrument       | Type                   | Current rating (FY2024)  |   | Chronology of rating history for the past 3 years |                               |                                 |                                 |
|------------------|------------------------|--------------------------|---|---|-------------------------------|---------------------------------|---------------------------------|
|                  |                        | Amount rated (Rs. crore) | Amount outstanding as of Nov 30, 2023 (Rs. crore) | Date & rating in FY2024                           | Date & rating in FY2023       | Date & rating in FY2022         | Date & rating in FY2021         |
|                  |                        |                          |   | Dec 18, 2023                                      | Sept 30, 2022                 | Jun 09, 2021                    | Apr 20, 2020                    |
| 1 Cash credit    | Long term              | 3.50                     | -   | [ICRA]BBB (Stable)                                | [ICRA]BBB- (Stable)           | [ICRA]BBB- (Negative)           | [ICRA]BBB- (Negative)           |
| 2 Term loans     | Long term              | 194.51                   | 166.06  | [ICRA]BBB (Stable)                                | [ICRA]BBB- (Stable)           | [ICRA]BBB- (Negative)           | [ICRA]BBB- (Negative)           |
| 3 Bank guarantee | Long-term/ Short- term | 8.00                     | -   | [ICRA]BBB (Stable) / [ICRA]A3+                    | [ICRA]BBB- (Stable)/ [ICRA]A3 | [ICRA]BBB- (Negative)/ [ICRA]A3 | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| 4 Unallocated    | Long term              | 38.88                    | -   | [ICRA]BBB (Stable)                                | -                             | -                               | [ICRA]BBB- (Negative)           |

### 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          |
| Long term – Unallocated                 | Not Applicable       |

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: [Click Here](#)

#### Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook  |
|------|-----------------|------------------|-------------|----------|--------------------------|-----------------------------|
| NA   | Cash credit     | NA               | NA          | NA       | 3.50                     | [ICRA]BBB(Stable)           |
| NA   | Term loans      | FY2018           | NA          | FY2027   | 194.51                   | [ICRA]BBB(Stable)           |
| NA   | Bank guarantee  | NA               | NA          | NA       | 8.00                     | [ICRA]BBB(Stable)/[ICRA]A3+ |
| NA   | Unallocated     | NA               | NA          | NA       | 38.88                    | [ICRA]BBB(Stable)           |

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

#### Annexure II: List of entities considered for consolidated analysis – Not Applicable

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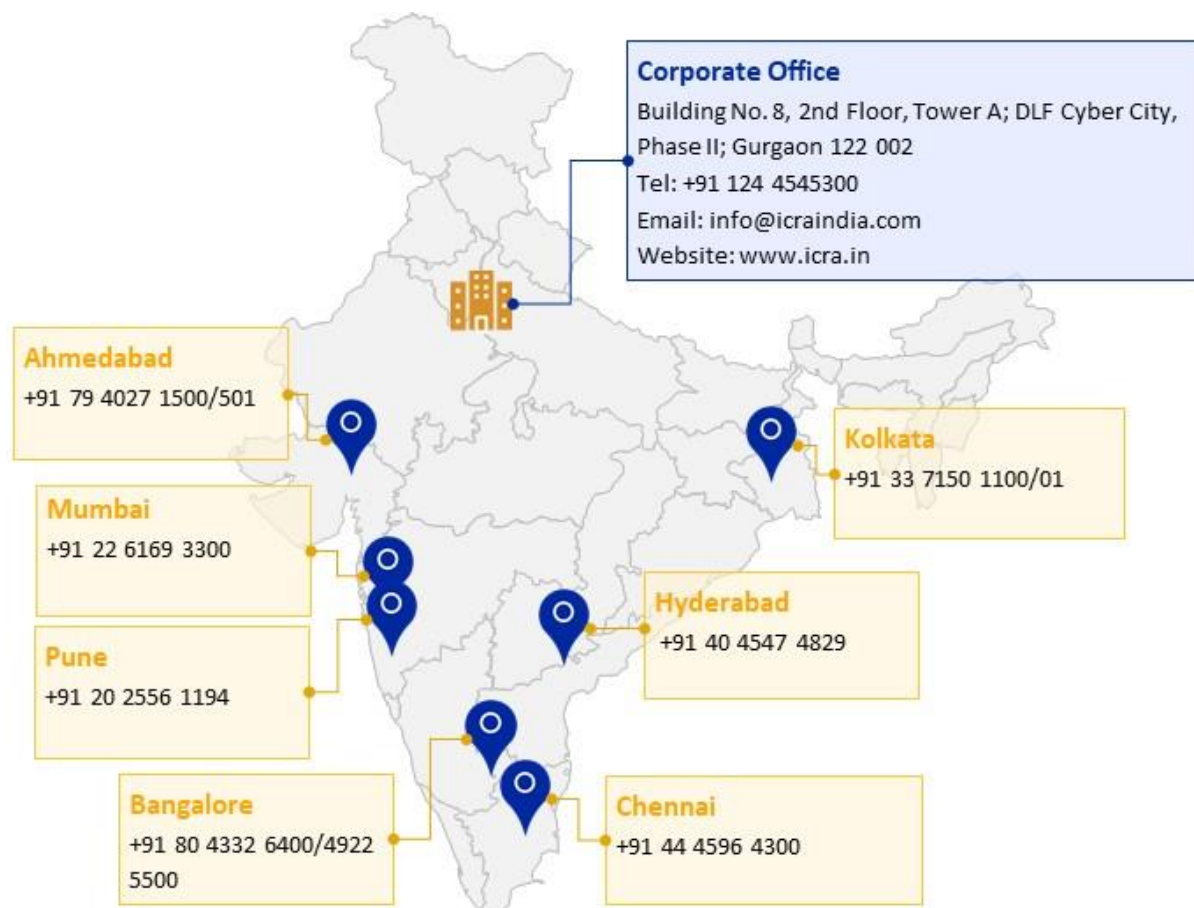


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