Hotel Diyalo Private Limited

Ratings

Facilities/ Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	650.00	CARE-NP BB- [Double B Minus]	Revised from CARE-NP B+
Short Term Bank Facilities	50.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	700.00 (Seven Hundred Million Only)		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Hotel Diyalo Private Limited (HDPL) to 'CARE-NP BB-' from 'CARE-NP B+' and has reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities of HDPL.

Detailed Rationale & Key Rating Drivers

The revision in the rating assigned to the long term bank facilities of HDPL considers the improving trend of operating income of the hotel in FY22 (Unaudited; FY refers to the twelve-month period ending mid-July), which is likely to sustain going forward supported by a favourable operating environment for the hotel amid improving occupancy. A continued rebound in operating income over the near-term is expected from sustained improvement in overall occupancy rates coupled with rental income from the recently operational casino unit in its premise. However, despite an improving income trend, the ratings continue to be constrained by the overall weak financial risk profile of the company marked by highly leveraged capital structure and modest debt servicing coverage indicators. The ratings are also constrained by operational stabilization risk given the generally long gestation period associated with hotel industry, also apparent in the inability of the hotel, notwithstanding the lingering impact of the covid-19 pandemic, to achieve revenue generation at earlier envisaged levels, exposure to volatile interest rates and susceptibility to cyclicality, intense competition in the hospitality sector.

The ratings, however, continue to derive strengths from experienced promoters of the company in various businesses including hospitality, association with reputed hotel brand and strategic locational advantage and government initiative and support for tourism industry. The ratings also take cognizance of the improving trend in both foreign and domestic tourist arrivals in the country in 2022 and likely growth trend expected over the medium-term, barring any setbacks, which augurs well for the overall hospitality sector.

Going forward, the ability of the company to improve occupancy level and average room rate (ARR) of the hotel on a sustained basis leading to growth in revenues and profit margins resulting in improved debt service coverage indicators will be key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Weak financial performance in initial years of operations, albeit improving trend in FY22

HDPL reported increase in total operating income (TOI) by 81% to Rs. 98 Mn during FY22 from Rs. 54 Mn during FY21 (Audited). The increase in TOI during FY22 was attributable to improvement in average annual occupancy rate to 34%

[1]Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

(FY21: 25%) aided by more meetings, incentives, conferencing, exhibitions (MICE) income during the year (~54% of total income). Consequently, PBILDT margin increased to 33.32% in FY22 from 19.85% in FY21. Despite increased revenue, however, with high interest and depreciation expense, the company reported net losses of Rs. 71 Mn in FY22. Nonetheless, the company has started operations of its casino unit from mid-October 2022, which is also expected to provide additional revenue support going forward in the form of rental income besides helping in bringing in more customers to the hotel. However, with lingering impact of the pandemic and the ongoing liquidity challenges in the economy, the company's ability to attract enough customers to run the hotel at an optimal occupancy level for a sustained period remains to be seen and will remain crucial from credit perspective.

Highly leveraged capital structure with weak debt service coverage indicators

The capital structure of the company is highly leveraged with overall gearing of above 16x at the end of FY22 which deteriorated from 5.93x at the end of FY21 majorly on account of net losses eroding networth of the company. Although the company has benefited from the relaxations provided by the Nepal Rastra Bank to the highly Covid19 impacted sectors such as tourism and hospitality, its ability to adequately service its debt obligations now that these relaxations are over will depend on its ability to generate sufficient income. Operational performance is likely to benefit from the increased tourist inflow expected over the medium term. Hence, the ability of the company to profitably scale up the operations leading to improved debt service coverage indicators will remain crucial from analytical perspective. In case, operational income is not sufficient to meet any debt obligations, financial support from promoters to meet any shortfall is expected, particularly as the operations of the hotel continues to ramp up going forward, barring any setbacks.

Operational stabilization risk and long gestation period associated with hotel industry

The company has set up a hotel with 60 rooms capacity which includes all modern amenities, F&B service, spa, conference hall, casino and other facilities. The hotel has come into operations since April 2019. However, the first couple of years of operations have been highly disrupted by the covid19 pandemic with low tourist count leading to below par occupancy levels and consequently lower revenue generation. Furthermore, hotels generally require longer gestation period to recover the associated fixed costs and become profitable. The long gestation period of hotels is on account of the construction of a premium hotel taking up to three to four years while stabilization of operations may take another two to three years. Notwithstanding the impact of the Covid19 pandemic, the ability of the company to attract customers, maintain occupancy level, establish its brand and derive benefit from the hotel as envisaged will be crucial from credit perspective.

Exposure to volatile interest rate

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in increased base rates of BFIs in the first half of FY23. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Susceptibility to cyclicality, intense competition and geographic concentration risk in the hospitality sector

The hotel industry of Nepal is fragmented in nature with the presence of large number of organized and unorganized players spread across various regions. The occupancy levels and revenue in the hotel industry are susceptible to macroeconomic trends, both in the domestic and global markets. The company's hotel located in Birgunj, thus exposing operations to geographic concentration risk. Furthermore, by catering largely to the hotel segment, revenue and profitability remain susceptible to business growth and the dynamics of the hotel industry.

Key Rating Strengths

Experienced directors of the company in various businesses

The company is managed under the overall guidance of the company's board of directors (BOD) who possess experience in various fields. Mr. Sunil Kumar Rungata is the Chairman and Managing Director, and has experience of over 26 years in trading and manufacturing sector through various companies. Mr. Vishal Patwari, director, has around two decades of experience in trading and manufacturing sectors. He is also a director in Ma Durga Foods Private Limited [CARE-NP BB-/A4], Jagdamba Enterprises Private Limited [CARE-NP BB+/A4+] and Jagdamba Construction & Developers Private Limited. Ms. Lila Aggrawal, director, has over one decades of experiences in manufacturing sector. She is also a director in Ma Durga Foods Private Limited, Ambe Cement Pvt. Ltd. [CARE-NP A3] and Jagdamba Falam Traders Private Limited. BOD are further supported by an experienced team across various functions/ departments.

Strategic locational advantage

The hotel is located in Birgunj, Parsa district of Nepal. Birgunj is one of the fastest developing metropolitan cities in Nepal and is also known as the 'Gateway to Nepal' and 'Commercial Capital of Nepal'. Its strategic location could remain the hotel's core strength as this would be preferred choice of business travelers and for business events in the post-pandemic era. Also, the influx of tourists is promising in Birgunj which is closely located to border town of Raxual at a distance of just 3 km which is also a major attraction for Indian tourist majorly for casino. Therefore, influx of tourists as well as business related visits is high in Birgunj, Nepal thereby providing opportunity to HDPL to cater to leisure as well as business tourists and cater to MICE.

Association with reputed hotel brand likely to benefit the company in terms of marketing and hotel operations

HDPL has entered into a licensed agreement with "Lords Inn Hotel and Developers Limited (Lords)" for more than 10 years and is operating the hotel under the name 'Diyalo Lords Plaza'. Lords is mid-segment hotel chain in India and owned by Lords Hotels & Resorts and operates over 40 hotel properties spread across India and Nepal. This will provide the hotel with an added benefit of established service, large customer base, proven experience, marketing assistance and brand name recognition to drive hotel guest bookings.

Government initiative and support for tourism industry

Tourism sector remains a prioritized sector of Nepal. In Budget Announcement for FY23 by Ministry of Finance, the government has allocated Rs. 9.38 Bn for tourism infrastructure development. Also, Unified Directives of 2020/21, whereby all the banks (type A, B C, D) have to allocate minimum share of their total advances to hospitality sector which augurs well for the sector. Similarly, Monetary Policy of 2022/23 had amended refinance procedure to covid-19 impacted industries. Additionally, development banks and finance companies are allowed to extend loan to tourism sector till the end of FY24. With the government prioritizing development of travel and tourism in the country, the prospect of this sector looks encouraging over the medium-term despite being marred by the intermittent waves of the Covid-19 pandemic in the recent past.

About the Company

HDPL was incorporated as a private limited company and constructed a hotel in Adarsh nagar, Birgunj, Nepal. The hotel is spread over 2.05 acres of land with a total of 60 rooms and other amenities. HDPL is four-star hotel operating under the commercial name of 'Diyalo Lords Plaza'.

Brief financial performance of HDPL during last 3 years is given below:

(Rs. in Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (UA)
Income from Operations	65	54	98
PBILDT Margin	11.00	19.85	33.32
Overall Gearing (times)	3.44	5.93	16.53
Interest coverage (times)	0.15	0.18	0.58
Current Ratio(times)	1.62	0.85	0.64
Total Debt/Gross Cash Accruals(times)	Negative	Negative	Negative

A: Audited; UA: Unaudited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	650.00	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limit	50.00	CARE-NP A4 [A Four]
Total		**700.00**	

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