TPS Eastern Africa Plc

Kenya Corporate Analysis **June 2018**

Rating class	Rating scale	Rating	Rating outlook	Review date
Long term	National	A-(KE)	Stable	June 2019
Short term	National	A2(KE)		

Financial data:

(USD'm comparative)

	31/12/16	31/12/17
KES/USD (avg.)	101.5	103.2
KES/USD (close)	103.0	103.2
Total assets	150.7	157.1
Total debt	36.0	43.4
Total capital	80.5	76.5
Cash & equiv.	14.1	6.5
Turnover	63.7	62.1
EBITDA	9.7	8.1
NPAT	1.8	1.4
Op. cash flow	5.8	6.3

Market cap.* KES6.0bn/USD59.5m
Market share n.a
*As at 12/06/2018@ KES101.01/USD.

Related methodologies/research:

Global master criteria for rating corporate entities, updated February 2018

TPS Eastern Africa Plc ("TPSEA" or "the group") rating reports, 2009-17

Rating history:

Initial Rating (June 2009)
Long term: BBB+(KE)
Short term: A2(KE)
Commercial paper: n.a
Rating outlook: Stable

Last Rating (July 2017)
Long term: A-(KE)
Short term: A2(KE)
Commercial paper: A2(KE)
Rating outlook: Stable

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Summary rating rationale

- The ratings take cognisance of TPSEA's well-established hotel and hospitality network, trading under the Serena brand, and consistent support from its key shareholder, the Aga Khan Fund for Economic Development, S.A ("AKFED").
- TPSEA is inherently exposed to the exogenous shocks in the operating environment, which have led to significant variability in earnings over the review period, thus constraining the ratings. That said, GCR notes that the underlying operations are efficiently run and the portfolio is well diversified, with the group posting operating profits in all the years under review.
- While revenue was flat at KES6.4bn in FY17, impacted by the limited capacity at the Nairobi Serena Hotel, it exceeded expectations due to strong performances in Tanzania and Uganda. Nevertheless, as staff costs were maintained at the Kenyan properties, earnings margins narrowed with a lower operating profit reported. Looking ahead, however, strong tourist arrivals into FY18, coupled with the scheduled completion of the first phase of upgrades at the Nairobi Serena Hotel, is expected to boost FY18 revenues, albeit that stable market conditions will be required to sustain such growth in the medium term.
- Cash generation has been varied in line with EBITDA over the review period. Positively, working capital changes have been moderate and predictable over the review period, reflecting the optimisation of stock control, procurement and debtors management for the group.
- Having been maintained at relatively low levels over the review period, group capital expenditure increased to KES1.9bn in FY17 (FY16: KES563m), driven by the upgrades on key properties. With only small capex projects planned beyond the completion of the Nairobi Serena Hotel ypgrade, little funding pressure is expected from the capex trajectory.
- Debt increased to a new high of KES4.5bn at FY17 (FY16: KES3.7bn), mainly due to additional drawdowns under the PROPARCO facility to finance the ongoing refurbishments. The group, however, remains well-capitalised, with gross gearing at 57% (FY16: 46%). While this is fairly moderate for the current ratings, GCR has taken into account the volatile nature of the tourism industry. Thus, fluctuations in earnings can have a substantial impact on credit metrics, as evidenced by the spike in net debt to EBITDA at FY17.
- TPSEA's strong access to funding, underpinned by a strong shareholder base and long-standing relationships with commercial banks, development agencies and related parties is considered in support of the ratings.

Factors that could trigger rating action may include

Positive change: Successful completion of the Nairobi Serena Hotel upgrades and demonstrated earnings enhancement therefrom. This should allow for a reduction in earnings-based gearing below 400%.

Negative change: Protracted weak performance or losses due to a deterioration in the business and socio-political environment or adverse regulatory changes, resulting in elevated gearing and debt service metrics.

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Business profile

Established in the 1970s and listed on the Nairobi Stock Exchange in 2006, TPSEA is a tourism services provider with operations in East Africa. It was founded by AKFED, an international development agency dedicated to promoting economic development in specific regions of the developing world. Over and above the strong financial support from AKFED, TPSEA leverages off the fund's global network to secure new business leads. The group is comprised of a network of Serena-branded properties, either directly owned by TPSEA, or managed under medium to long-term, renewable contracts. In addition to eight subsidiaries and affiliates, TPSEA manages six other Serena-branded properties.

TPSEA: operating subsidiaries and properties			
TPS (Kenya) Ltd (7 properties) 100%	TPS (Tanzania) Ltd (8 properties) 100%	TPS (Uganda) Ltd (2 properties) 65%°	TPS (Zanzibar) Ltd (1 property) 100%
Mountain Lodges Ltd (1 property) 30%	TPS (D) Ltd (1 property) 25%	TPS (Rwanda) Ltd (2 properties) 20%	TPS (SA) Pty Ltd Sales & Marketing 100%†

°Includes the Lake Victoria Serena Resort, a managed property.
†TPSEA's marketing office based in South Africa.

The broader Serena brand spans 35 luxury resorts, hotels, safari lodges and tented camps located in Eastern Africa and Southern Asia. Supported by a centralized Sales and Marketing team that includes overseas representatives, TPSEA has been able to retain important holiday tourism within the group by transferring client bookings to other regional properties if one country or region is affected by adverse developments. Thus, note is taken of advantages TPSEA derives from the wide network. However, events such as the terrorism threat and the Ebola outbreaks in West Africa had a pervasive contagion effect on the whole region, and largely accounted for the group's erratic earnings over the review period. More recently, changes to concession levies and park fees, as well as the revocation of tourist hunting licenses in Tanzania threatened to curtail the growth of the industry in that country.

Since establishment, growth has largely been driven by acquisitions, with the group following an extensive due diligence of any targeted properties. Assets are usually acquired to grow TPSEA's geographic presence in the region or to enhance one of its underlying offerings, for example, the safari circuit or conference facilities in an underserviced locality. TPSEA initially acquires an associate stake in such entities and when performance has been enhanced by upgrades to the property or changes to management and internal processes, TPSEA then progressively increases its stake in such companies from associate level until they are fully integrated as subsidiaries. In this regard, during FY17 the group, through TPS Tanzania, acquired the remaining 49% in Upekee Lodges Limited ("ULL") to attain 100% control of the business, bringing the total number of wholly-owned TPS properties in Tanzania to eight. ULL operates two properties in the Selous Game Reserve in southern Tanzania, and the acquisition affords the group greater exposure to the Southern circuit. In the long term, management expects to eventually integrate properties such as Dar es Salaam Serena Hotel, Kigali Serena Hotel, Lake Kivu Serena Hotel and Polana Serena Hotel in Mozambique, which are currently under management contracts. In FY17, TPSEA secured a contract to manage an additional property under the Serena brand in Goma, Democratic Republic of Congo (DRC), set to commence in 2019.

The exogenous challenges faced by the group notwithstanding, underlying operations continue to be well run, with a strong management team having been retained since the listing. The group's management structures and corporate profile have remained largely unchanged over the same period, barring the integration of new properties in line with its long-term investment mandate. A list of the group's current properties is shown in table 1.

Table 1: TPSEA properties (abbreviation)	
Kenya	**Tanzania**
Nairobi Serena Hotel (NSH)	Kirawira Serena Camp (KCAM)
Serena Beach Resort & Spa (SBRS)	Lake Manyara Serena Safari Lodge (LMSL)
Amboseli Serena Safari Lodge (ASSL)	Serengeti Serena Safari Lodge (SSER)
Mara Serena Safari Lodge (MSSL)	Ngorongoro Serena Safari Lodge (NSSL)
Kilaguni Serena Safari Lodge (KSSL)	Arusha Serena Hotel (ASH)
Sweetwaters Serena Camp & Ol Pejeta House (SWTC)	Mbuzi Mawe Serena Camp (MMSC)
Lake Elmenteita Serena Camp (LESC)	Serena Mivumo River Lodge (SMRL)
	Selous Serena Camp (SSC)
Uganda	**Zanzibar**
Kampala Serena Hotel (KSHU)	Zanzibar Serena Hotel (ZSH)
TPSEA managed properties (rooms)	
Serena Mountain Lodge - Kenya (MLL)*	
Dar es Salaam Serena Hotel- Tanzania (DSH)	
Lake Victoria Serena Golf Resort & Spa- Uganda (LVSR)	
Kigali Serena Hotel– Rwanda (KISH)	
Lake Kivu Serena Hotel– Rwanda (LKSH)	
Polana Serena Hotel– Mozambique (PSHM)	

*The company which owns Serena Mountain Lodge: TPSEA holds a 30% stake *via* TPS (Kenya).

In recent years, TPSEA has focused on upgrading its large properties in major cities to maintain its market leadership position in the face of increasing competition. In this regard, refurbishments at the Kampala Serena Hotel were completed in FY17. The upgrades saw the addition of 32 deluxe rooms, three business suites and a second presidential suite. There are also more meeting rooms and new media hub functionalities, positioning the hotel to host high profile meetings. Adding to the premium offering, an additional executive lounge was added and a new champagne bar opened in March 2018, the largest in Uganda.

The extensive upgrades at the group's flagship property, the Nairobi Serena Hotel, are still ongoing. The number of rooms is set to increase from the current 183 to 199, while the existing rooms will also be upgraded. Other facilities include a new ballroom, a parking lot for an additional 120 cars, a new executive lounge and a new specialty restaurant. Management expects the first phase of refurbishments to be complete by 2H FY18, while the final completion is scheduled for January 2019. The enhanced offerings are expected to command higher rates, and support revenue growth. Although the hotel has only had around 50% of capacity available as a result of the construction activity, its performance has been above expectations, with high occupancy rates on available rooms, despite the disruptions. Nevertheless, the loss of revenue from rooms unavailable due to construction, negatively impacted overall group performance.

Given the advanced stage of the upgrades, the loan facilities from PROPARCO, amounting to USD20m for Nairobi Serena Hotel, and USD8m for Kampala Serena Hotel, were fully drawn down at FY17.

Corporate governance

AKFED has retained effective control of TPSEA since its relisting, and has maintained its direct stake in the group at 45% over the five years under review. The balance is mostly held by corporates affiliated to Aga Khan Development Network ("AKDN"), PROPARCO, and other corporate/institutional investors. TPSEA's directors hold a modest combined stake in the group, which at FY17 equated to less than 0.01% of the issued shares.

Table 2: Corporate governance checklist	
Directors - Executive	Two
- Non-executive	Eight, with one alternate.
Frequency of meetings	Four times p.a. *Ad hoc* meetings where necessary.
Separation of the chairman	Yes, Chairman is separated from MD and is independent.
Board committees	Audit; Nomination & Remuneration. (Both committees are mandatory and set out in the Board's terms of reference).
Internal control/compliance	Yes, reports to Audit committee.
External auditors	PriceWaterhouseCoopers.

The group remains in full compliance with the Capital Markets Authority's Corporate Governance Guidelines. It therefore maintains a quota of independents of at least a third of its well-constituted board of directors. All board members (except the executive directors) are put up for re-election or rotation every three years, as per regulatory guidelines. Board committees are staffed and chaired by independents. During FY17, the board transitioned the planned retirement of Mr Abulmalek Virani, Group Finance Director to be replaced by Nooren Hirjani, as the Group Chief Finance Officer. The group has been audited by PWC, receiving unqualified audit reports for the five years under review.

Operating environment

Table 3: Economic overview	2014	2015	2016	2017	2018[f]
Real GDP growth (%)	5.3	5.6	5.8	5.3	5.5
GDP per capita (USD)*	1,430	1,439	1,516	1,607	1,608
Inflation (annual avg. % Δ)	6.9	6.6	6.3	8.0	5.2
Govt. debt: GDP (%)	43.9	52.4	54.4	56.7	55
Current account: GDP (%)	(9.8)	(6.8)	(5.5)	(5.6)	(5.0)
KES: USD (avg.)	87.9	98.2	101.5	103.0	n.a

*Current prices. f – forecast
Source: IMF, Oanda

Following robust growth in 2016, the Kenyan economy expanded at a marginally lower rate of 5% in 2017, impacted by the severe drought, lower levels of credit supply to the private sector as a result of the capping of interest rates, as well political instability. In particular, uncertainty in the wake of the protracted general election saw many infrastructure projects being delayed and retailers reducing stock levels.

Annual inflation averaged 8% in 2017, higher than the 6.3% in 2016. This rise in inflation was largely attributable to the impact of the drought on food prices. Positively, the Kenyan Shilling remained largely stable in 2017 amidst the economic headwinds, depreciating by just 1.7% against the USD. The capping of interest rates, introduced in September 2016, was meant to stimulate economic growth by offering cheaper access to credit. However, the actual result has been a tightening of credit supply to the private sector, particularly SMEs, as lenders shunned riskier credit profiles, given their inability to price rates accordingly. The Kenya government has now signaled that this could be scrapped, although the timing of such regulatory amendments remains unknown. Removing the cap is expected to increase credit supply to SMEs, which have been the drivers of employment creation and economic growth in recent years.

Favourable weather conditions are expected to support increased grain production and tea exports in 2018, whilst manufacturing sector growth should rebound to 4.5% in 2018 (2017: 2.7% growth) on the back of increased agro-processing output. However, the rapid growth in the construction industry is expected to moderate to 6.9% in 2018 (2017: 8.5%), with the value of approved building plans on Nairobi declining by 18%. Against this background, the World Bank projects GDP growth to accelerate to 5.5% in 2018. However, the high level of government debt, which currently stands at 57% of GDP, remains a risk to sustainable long-term growth, as fiscal consolidation may slow down government-driven economic activity.

Despite the uncertainty resulting from the general elections, Kenya's tourist arrivals rose by c.10% to 1.5 million in 2017, on the back of improving international perceptions and more active marketing in source markets. Accordingly, national tourism earnings rose to an all-time high KES120bn (2016: KES100bn). For 2018, an increase in tourist arrivals from North America and Europe is forecast, supported by the introduction of direct flights between Nairobi and New York from October, as well as more frequent flights between France and Nairobi. The government of Kenya, through the Kenya Tourism Board, is also intensifying marketing efforts in non-traditional source markets such as China and India to support sustainable growth in arrivals in the medium term. In this regard, arrivals from China alone increased by 43% in 2017, and are expected to rise by a further 35% in 2018.

The burgeoning middle class is expected to support robust growth in domestic tourism, with 15% growth in bed nights taken by Kenyans projected in 2018, from the 4 million in 2017. A number of high profile international conferences are also scheduled in 2018, as the industry diversifies from being solely a safari destination to include business tourism and meeting, incentive, conference and exhibition (MICE) destinations. The government continues to support the industry by providing and maintaining critical infrastructure, as demonstrated by the swift intervention to restore accessibility to the Masai Mara game reserve after the roads had been destroyed by floods in May 2018. Against this background, the Kenya tourism sector is projecting a 16% growth in 2018 (2017: 20%).

In Tanzania, tourism remains a key sector in the economy, earning over USD2.2bn in 2017 and contributing 17% to the country's GDP, to go along with 500,000 jobs. However, following the introduction of new taxes on tourism services, which saw an increase in concession and park fees, growth in tourist arrivals in Tanzania declined to just 3% in 2017, from the 13% in 2016. Since April 2018, the Tanzania tourism industry has also been battling negative publicity emanating from the displacement of indigenous communities for the expansion of safari activities. Nevertheless, tourist arrivals are projected to increase by 10% in 2018, on the back of aggressive marketing initiatives by the Tanzania Tourism Board.

In Uganda tourist arrivals increased by 4% to 1.3 million visitors in 2017, and the Uganda Tourism Board (UTB) is projecting this number to rise to 1.56 million in 2018. In recognition of its importance to the economy, the Uganda government has over the past few years invested significantly in improving infrastructure such as roads to support the tourism industry, with the UTB announcing that 6 of the country's mountain resorts will be equipped with cable cars to boost tourist arrivals. From 2016, international public relations and marketing firms were contracted in key source markets, which is also expected to support tourist arrivals in the medium term in the face of weak domestic tourism.

In Rwanda, tourist arrivals continue to increase against the country's growing reputation as a leading conferencing destination. According to the tourism board, the country hosted 169 international conferences in 2017. Nevertheless, an oversupply of hotel rooms has resulted in pricing pressure. Although there are strong prospects for the gorilla circuit in the DRC where TPSEA looks to expand into, the recent Ebola outbreak and security lapses could reverse the gains the country had made in promoting tourism.

Overall tourist arrivals have been increasing in all east African nations over the past 3 years. This can be attributed to the joint marketing as well as the simplification of visa requirements when foreigners travel across east Africa. In this regard, during 2017 Kenya, Uganda and Tanzania launched the East Africa Tourism Portal, a joint tourism promotional platform that allows tourism trade operators to organise multi-country packages for tourists within the region. This is expected to boost international arrivals as well as regional tourism in the medium term.

Earnings diversification[1]

Despite declining to KES2.6bn in FY17 (FY16: KES2.9bn), revenue in the Kenya Hotels and Lodges segment was above management expectations. The decline was a result of the limited capacity at the flagship asset Nairobi Serena Hotel, due to the ongoing expansion and refurbishments. Having previously accounted for over 50% of local revenues, the FY17 contribution from Nairobi Serena Hotel declined to c.20% of the total, as more than half the rooms and the conferencing facilities were unavailable. However, it has been necessary to keep a certain staff complement at the property and even in the underperforming resorts (such as the Mombasa property) to maintain the group's quality and service standards, thus limiting the extent to which costs can be scaled back in such a downturn. Accordingly, the decline in local revenue resulted in the Kenya Hotels and Lodges posting a loss at the EBITDA level. Positively, the first phase of the refurbishment works is expected to be complete by 2H FY18, whereafter higher rates are expected from the refurbished rooms, and improved banqueting and conferencing facilities. Further, the resolution of political concerns has supported a rebound in arrivals and thus occupancy rates across all the Serena safari properties during 1Q FY18.

Table 4: Kenya hotels & lodges (KES'm)	**FY14**	**FY15**	**FY16**	**FY17**
Revenue	2,766	2,752	2,916	2,559
EBITDA	234	190	242	(68)
Op. profit*	60	0.4	31	(248)
Total assets	5,715	5,772	6,068	8,559
Revenue %Δ	(13.0)	(0.5)	5.9	(12.2)
EBITDA margin (%)	8.4	6.9	8.3	neg.
Op. margin (%)	2.2	0.0	1.1	neg.
Asset turnover (x)	0.5	0.5	0.5	0.3

* Including exchanges gains/(losses) from operating activities. Note: Total asset balances are stripped of intangible assets, as per standard GCR methodology.

Business tourism volumes are projected to remain sound, as TPSEA continues to leverage its conferencing facilities and options for clients within the network. However, the hotel in the coastal region continues to record low occupancies, as a result of lack of charters and international flights into Mombasa from the main source markets. The recent opening of the Standard Gauge Railway, which connects Nairobi and Mombasa, has eased travel to the coast and it is anticipated to support the recovery of coastal resorts in the medium term. According to management, bookings for 2H FY18 are picking up across the safari circuit in anticipation of the Masai Mara Migration from July to November, and the government of Kenya has also commenced maintenance works on roads connecting Nairobi to the game reserve that had been destroyed by flooding in April 2018.

Table 5: Tanzania lodges (KES'm)	**FY14**	**FY15**	**FY16**	**FY17**
Revenue	2,019	1,767	1,850	2,083
EBITDA	149	-137	327	469
Op. profit*	8	-280	145	337
Total assets	3,923	3,490	3,668	2,913
Revenue %Δ	-5.1	-12.5	4.7	12.6
EBITDA margin (%)	7.4	-7.8	17.7	22.5
Op. margin (%)	0.4	-15.9	7.8	16.2
Asset turnover (x)	0.5	0.5	0.5	0.7

* Including exchanges gains/(losses) from operating activities. Note: Total asset balances are stripped of intangible assets, as per standard GCR methodology.

Despite the regulatory changes and higher fees and taxes, the Tanzania safari circuit registered a 12.6% increase in revenue to KES2.1bn in FY17. An influx of alternative business and leisure accommodation has increased the intensity of competition in the Tanzania safari circuit, particularly the development of permanent and mobile tents in the Serengeti. This competition notwithstanding, Serena Tanzania properties continue to command leadership positions in their respective regions by improving their offering, with both EBITDA and operating margins widening to review period highs of 23% and 16% in FY17 respectively (FY16: 18%; 8%). During FY17, the Dar es Salaam Serena Hotel unveiled its upgraded facilities such as a bigger poolside bar, gym and a steam room to strengthen its position in the competitive

[1] Note: Minor discrepancies in the amounts, totals and ratios depicted in ensuing sections of the report that are due to rounding.

market. Zanzibar tourist arrivals have rebounded following a brief decline related to some political tension in 2016. Management has indicated that active marketing efforts are continuing in non-traditional source markets, including China, India and Brazil to diversify its international tourist base.

Despite the opening of a number of hospitality establishments in the country, TPS (Uganda) Limited recorded a modest growth in revenue. The recently completed upgrades at Kampala Serena Hotel, which added 36 new rooms, are expected to support strong earnings uplift in the medium term. The operating margins remained robust at 19% in FY17 (FY16: 17%), albeit lower than the FY15 level of 24%, indicating increasing competitive pressure. Looking further ahead, the group continues to invest in the performance of properties it manages in the country, which may be co-opted as subsidiaries in the medium term. The Lake Victoria Serena Golf Resort in particular has witnessed robust growth, buoyed by its enhanced facilities and revamped golf courses that are expected to host some high-profile golf tournaments from 2018.

Table 6: Uganda hotels (KES'm)	FY14	FY15	FY16	FY17
Revenue	1,493	1,612	1,631	1,692
EBITDA	398	486	415	419
Op. profit*	299	400	273	327
Total assets	2,330	2,627	3,287	3,116
Revenue %Δ	3.4	8	1.2	3.7
EBITDA margin (%)	26.6	30.1	25.4	24.8
Op. margin (%)	20	24.8	16.7	19.3
Asset turnover (x)	0.6	0.7	0.5	0.5

* Including exchanges gains/(losses) from operating activities. Note: Total asset balances are stripped of intangible assets, as per standard GCR methodology.

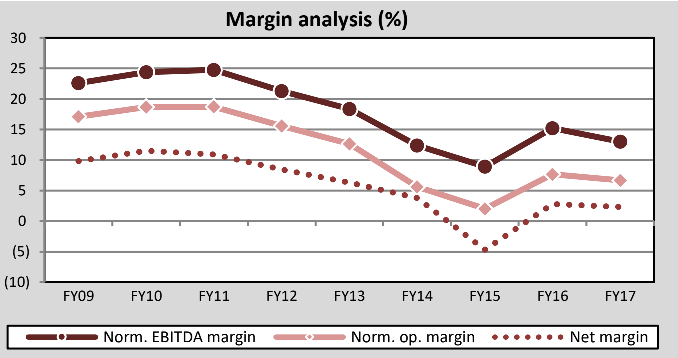
Financial performance

A five-year financial summary of TPSEA's financials is appended to this report, with brief commentary hereafter.

Table 7: Income statement (KES'm)	FY14	FY15	FY16	FY17	YoY %Δ
Turnover	6337	6189	6469	6408	(0.9)
EBITDA	**782**	**552**	**974**	**832**	**(15.0)**
Depreciation	(426)	(427)	(488)	(406)	14.5
Operating income	356	125	485	425	(12.4)
Net finance charge	(154)	(224)	(173)	(135)	(22.0)
Forex movements	(18)	(122)	52	3	(94.2)
Impairments	-	-	(50)	-	n.a
NPAT	**238**	**(291)**	**118**	**149**	**26.3**
Turnover (%Δ)	(7.0)	(2.3)	4.5	(0.9)	
Operating margin (%)	5.6	2	7.5	6.6	
Net interest cover (x)	2.3	0.6	2.8	3.1	

Group revenue was flat at KES6.4bn in FY17. However, this was largely expected due to the closure of much of the Nairobi Serena Hotel. Nevertheless, this foregone revenue was offset by the strong performance in Tanzania and Uganda. This highlights the diversification benefits from exposure to different markets that has largely sustained the group profitability through the cycle. Positively, the rebound in tourism experienced in Kenya during 1Q FY18, coupled with the scheduled completion of the first phase of upgrades at Nairobi Serena Hotel, is expected to boost FY18 revenues, albeit that stable market conditions will be required to sustain such growth in the medium term.

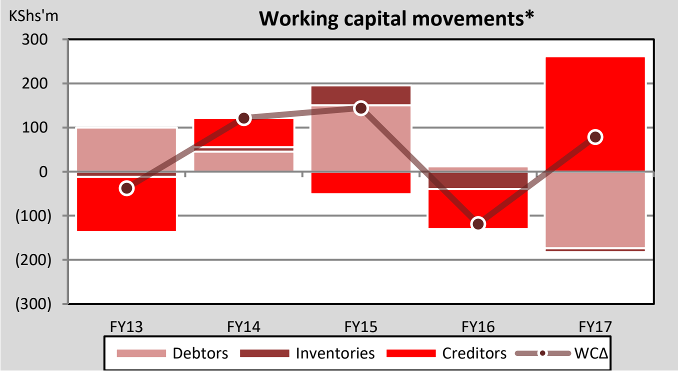
EBITDA declined to KES832m in FY17 (FY16: KES974m) at a lower margin of 13% (FY16: 15%). This was mainly due to the lower revenue, which was not matched by a commensurate decline in costs. As discussed, it has been necessary to maintain staffing levels at a certain minimum threshold so as to main the hotels' standards. As such the group's average staff complement remained around 2,800 in FY17. Staff expenses are the largest component of operating costs, accounting for 36% of the total in FY17 (FY16: 35%). That said, the cost discipline maintained over the years is noted, with other operating expenses and the inventory expensed declining marginally in FY17, despite higher overall inflation in Kenya and Tanzania. This is expected to support sustainable increases in the EBITDA margins once a return to revenue growth is achieved. After accounting for depreciation, the group reported operating income of KES425m in FY17 (FY16: KES485m), with operating margin also lower at 6.6% (FY16: 7.5%).



Despite an increase in debt, the gross interest expense fell to KES149m in FY17 (FY16: KES184m), as TPSEA benefitted from lower interest rates in Kenya. Interest income remained flat at KES11m, thus net interest cover improved marginally, from 2.9x in FY16 to 3.1x in FY17. With the CBK signaling that the interest rate cap may be abolished, there is potential for the net interest charge to increase in FY18, but this would comfortably be covered by projected higher revenue. The Kenyan Shilling remained fairly stable during FY17, resulting in exchange gains declining to just KES3m (FY16: KES52m). Overall, NPBT fell to KES290m (FY16: KES374m) in line with the decline in operating income.

Cash flows

Having risen sharply to KES1bn in FY16, cash generated by operations moderated to KES832m in FY17, in line with the lower EBITDA. Positively, working capital changes have been moderate and predictable over the review period, reflecting efforts to optimise inventory holdings, procurement and debtors management for the group. For FY17, a small release of KES78m (FY16: KES117m) was recorded, driven by an increase in payables. After accounting for the lower finance charges and taxes, cash flow from operations increased to KES649m (FY16: KES590m).



Having been maintained at relatively low levels over the review period, group capital expenditure increased to KES1.9bn in FY17 (FY16: KES563m). This was driven largely by the expansion and refurbishments being carried out on a number of the group's properties. A further KES309m was spent on the acquisition of a 49% stake in Upekee Lodges Limited in Tanzania. The capex pipeline for FY18 includes the second phase of the Nairobi Serena Hotel expansion, which is expected to be completed by January 2019. Recognising the need for cash to fund capex, lower dividends of KES64m were paid in FY17 (FY16: KES46m), while a similar dividend has been declared to be paid during FY18. With capex funded by a mix of borrowings and cash that had been raised the previous year, net debt increased by KES1.5bn in FY17 (FY16: KES54m)

Funding and liquidity profile

TPSEA reported total assets of KES16.2bn at FY17, a review period high. Consistent with the group's funding model where properties are owned rather than leased, the balance sheet is highly fixed-capital intensive, with fixed assets representing 78% of total assets at FY17 (FY16: 72%). Fixed capital also included work in progress of KES2.4bn (FY16: KES809m). Non-cash current assets constitute a further 12% (FY16: 12%), being trade receivables, prepayments and inventories, while the KES674m in cash constituted just 4% of total assets (FY16: 9%).

Derived from a large and diverse base of unrelated customers, the quality of trade receivables remains sound. TPSEA's trade receivables are usually settled quickly, with an average trade debtors days of 39 at FY17 (FY16: 30 days). Nevertheless, debtors are occasionally distorted by slower receipt of payments from the government, but the effect on gross debtors is small. Investments comprise entirely of shareholding in certain other hospitality businesses within the broader Serena brand, held largely in conjunction with related parties such as the AKFED and PROPARCO.

TPSEA remains relatively well capitalised at FY17, with shareholders' equity of KES7.9bn at FY17 (FY16: KES8.1bn) accounting for 49% of total funding (FY16: 53%). The decline in tangible equity over the review period is attributable to movements in the currency translation reserve account. Trade creditors and other interest free sources remained stable at 24% (FY16: 23%) of total funding.

Table 9: Funding profile (KES'm)	FY13	FY14	FY15	FY16	FY17
Tangible equity	**9,246**	**9,088**	**8,361**	**8,093**	**7,890**
Short term debt	890	1,084	609	516	657
Long term debt	872	904	1,968	3,188	3,820
Total debt	**1,762**	**1,988**	**2,577**	**3,703**	**4,477**
Cash & cash equivalents	273	285	432	1,452	674
Net working capital*	387	141	(3)	115	36
Fixed assets	11,296	11,187	10,976	11,156	12,593
Net gearing (%)	16.1	18.7	25.7	27.8	48.2
Net debt: EBITDA (%)	119.1	217.7	388.9	231.3	457.3
Net interest cover (x)	6.0	2.3	0.6	2.8	3.1
OCF: debt service (x)	1.7	0.7	0.5	1.1	1.0
Cash: ST debt (x)	0.3	0.3	0.7	2.8	1.0

* Debtors, prepayments and inventories, less creditors.
Note: Equity balances are stripped of intangible assets, as per standard GCR methodology. These equated to KES1.3bn at FY17 (FY16: KES1.3bn).

Debt increased 21% to a new high of KES4.5bn at FY17 (FY16: KES3.7bn). This was mainly due to additional drawdowns under the PROPARCO USD-denominated facility, with the exposure having increased to KES2.8bn (FY16: KES2.0bn). The balance of the debt relates to operational facilities predominantly drawn from a pool of five banks in Kenya, Uganda and Tanzania, led by Barclays Bank and Stanbic Bank. Management has however indicated an intention to consolidate the group's short term working capital facilities between its main bankers. The bank facilities are secured by a combination of properties, shares and the assignment of receivables, while the PROPARCO facility is secured by a TPSEA corporate guarantee. Positively, about 85% of the debt is long term. Although KES3.4bn of the debt (representing 77% of the total) is USD-denominated, foreign exchange risk is considerably mitigated by the natural hedge derived from TPSEA's USD-denominated revenues.

Gross gearing rose to a review period high of 57% at FY17 (FY16: 45%). While this appears moderate, ssome concern is raised to the sharp increase in net debt to EBITDA to 457% at FY17 (FY16: 231%), a review period high. Although the metric was amplified by the decline in EBITDA, it does highlight the potential credit risks facing TPSEA if strong earnings are not sustained. Debt serviceability remained sound for the current ratings with interest cover at 3.1x (FY16: 2.8x), although an increase in interest rates may lead to elevated risk if not accompanied by higher earnings. That said, the group's longstanding relationships with a wide range of reputable funders, as well as a committed and strong shareholder base, are positively considered in support of the ratings.

Outlook

TPSEA's prospects are closely correlated to the general performance of the tourism and hospitality industry in East Africa. Thus, the stronger growth in tourist arrivals expected in FY18 should support robust organic earnings growth. More significantly, the first phase of upgrades at the Nairobi Serena Hotel should be completed during FY18, to further enhance the group's earnings. For the two months to February 2018, occupancies across the group's properties have increased compared to the same period in the prior year, albeit marginally lower than budget. Bookings ahead of the safari season have evidenced encouraging signs, with management expecting full occupancies during the Masai Mara migration. This is expected to support earnings growth.

From a gearing perspective, TPSEA remains conservatively geared, with management indicating an internal net gearing limit of 40%. Although gearing is currently in excess of the level, it is expected to settle once the current large capex project is complete. While the gearing is fairly moderate for the current ratings, GCR has taken into account the volatile nature of the tourism industry. Thus, fluctuations in earnings can have a substantial impact on credit metrics, as evidenced by the spike in net debt to EBITDA at FY17. The interest coverage of 3.1x is considered adequate for the current ratings range, and further comfort is derived from the longstanding relationships with multiple reputable financial institutions.

TPS Eastern Africa Plc

(Kenyan shillings in millions except as noted)

Year end: 30 September	2013	2014	2015	2016	2017
Income Statement					
Turnover	6,814.3	6,337.2	6,189.4	6,468.8	6,408.2
EBITDA	**1,250.3**	**782.4**	**551.5**	**973.5**	**831.5**
Depreciation	(388.2)	(426.2)	(426.6)	(488.3)	(406.5)
Operating income	**862.0**	**356.2**	**124.9**	**485.2**	**425.0**
Net finance charge	(144.8)	(154.4)	(224.2)	(172.7)	(138.0)
Exchange gain/(loss)	16.7	(17.6)	(121.6)	51.6	3
Amortisation	0.0	0.0	0.0	(50.0)	0
NPBT	**733.9**	**184.1**	**(220.9)**	**314.0**	**290.1**
Taxation paid	(304.7)	54.3	(69.6)	(196.0)	(141.3)
NPAT	**429.2**	**238.4**	**(290.5)**	**118.1**	**148.8**
Earnings from associates and minority interests	7.5	(6.1)	(6.1)	(29.9)	(83.6)
Attributable earnings	**411.4**	**245.9**	**(296.6)**	**88.2**	**65.2**
Cash Flow Statement					
Cash generated by operations	**1,267.7**	**767.4**	**423.7**	**1,030.0**	**832.1**
Utilised to increase working capital	(27.3)	30.1	99.8	(116.9)	78.1
Net finance charges	(144.8)	(172.7)	(224.2)	(224.2)	(138.0)
Taxation paid	(142.1)	(150.5)	(149.8)	(149.8)	(123.4)
Cash flow from operations	**953.5**	**480.4**	**149.5**	**589.9**	**648.8**
Maintenance capex *	(388.2)	(488.3)	(350.3)	(350.3)	(406.5)
Discretionary cash flow from operations	**565.2**	**54.2**	**(200.8)**	**101.6**	**242.3**
Dividends paid	(192.7)	(45.5)	(245.9)	(45.5)	(63.8)
Retained cash flow	**372.5**	**56.1**	**(446.7)**	**56.0**	**178.5**
Net expansionary capex	(174.5)	(75.0)	0.0	(75.0)	(1,801.9)
Investments and other	92.7	68.3	0.0	0.0	0.0
Proceeds on sale of assets/investments	1.4	0.1	8.2	14.8	1.4
Shares issued	0.0	0.0	0.0	0.0	0.0
Cash movement: (increase)/decrease	(18.1)	(12.0)	(147.0)	(1,019.2)	777.2
Borrowings: increase/(decrease)	(342.1)	144.2	461.2	1,073.1	710.2
Net increase/(decrease) in debt	**(360.2)**	**132.3**	**314.2**	**53.9**	**1,487.4**
Balance Sheet					
Ordinary shareholders interest	**8,266.7**	**8,080.4**	**7,239.3**	**7,089.3**	**7,141.5**
Outside shareholders interest	979.4	1,007.9	1,121.9	1,004.0	749.0
Total shareholders' interest	**9,246.1**	**9,088.3**	**8,361.2**	**8,093.4**	**7,890.5**
Short term debt	889.8	1,084.5	608.9	515.6	657.1
Long term debt	872.2	903.9	1,968.2	3,187.6	3,819.7
Total interest-bearing debt	**1,762.0**	**1,988.4**	**2,577.1**	**3,703.2**	**4,476.8**
Interest-free liabilities	3,581.9	3,328.1	3,363.3	3,713.5	3,844.5
Total liabilities	**14,589.9**	**14,404.8**	**14,301.7**	**15,510.1**	**16,211.8**
Fixed assets	11,295.6	11,186.6	10,976.2	11,156.3	12,592.6
Investments and other	1,023.3	991.0	1,000.9	1,002.0	972.6
Cash and cash equivalent	273.5	285.4	432.4	1,451.6	674.4
Other current assets	1,997.6	1,941.7	1,892.2	1,900.2	1,972.2
Total assets	**14,589.9**	**14,404.8**	**14,301.7**	**15,510.1**	**16,211.8**
Ratios					
Cash flow:					
Operating cash flow: total debt (%)	54.1	24.2	5.8	15.9	14.5
Discretionary cash flow: net debt (%)	38.0	3.2	neg	4.5	6.4
Profitability:					
Turnover growth (%)	27.5	(7.0)	(2.3)	4.5	(0.9)
EBITDA: revenues (%)	18.3	12.3	8.9	15.0	13.0
Operating profit margin (%)	12.7	5.6	2.0	7.5	6.6
EBITDA: average total assets (%)	9.6	5.5	3.9	6.9	5.7
Return on average equity (%)	5.5	3.0	neg	1.2	0.9
Coverage:					
Op. income: gross interest (x)	4.9	2.2	0.5	2.6	2.8
Op. income: net interest	6.0	2.3	0.6	2.8	3.1
Activity and liquidity:					
Days receivable outstanding (days)	30.6	28.4	73.5	30.9	39.0
Current ratio (:1)	0.9	0.8	1.0	1.6	1.1
Capitalisation:					
Net debt: equity (%)	16.1	18.7	25.7	27.8	48.2
Total debt: equity (%)	19.1	21.9	30.8	45.8	56.7
Total debt: EBITDA (%)	119.1	217.7	388.9	231.3	457.3
Net debt: EBITDA (%)	140.9	254.1	467.3	380.4	538.4

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S CORPORATE GLOSSARY

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Capital	The sum of money that is invested to generate proceeds.
Cash Equivalent	An asset that is easily and quickly convertible to cash such that holding it is equivalent to holding cash. A Treasury Bill is considered cash equivalent.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash Flow Statement	The cash flow statement shows the cash flows associated with the operating, investing and financing activities of a company, combining to explain the net movement in cash holdings.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Commodity	Raw materials used in manufacturing industries or in the production of foodstuffs. These include metals, oil, grains and cereals, soft commodities such as sugar, cocoa, coffee and tea, as well as vegetable oils.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Rating Agency	An entity that provides credit rating services.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Currency Risk	The potential for losses arising from adverse movements in exchange rates.
Current Ratio	A measure of a company's ability to meet its short-term liabilities and is calculated by dividing current assets by current liabilities. Current assets are made up of cash and cash equivalents ('near cash'), accounts receivable and inventory, while current liabilities are the sum of short-term loans and accounts payable.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
DFIs	Development Finance Institutions.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
EBITDA	EBITDA is useful for comparing the income of companies with different asset structures. EBITDA is usually closely aligned to cash generated by operations.
Economic Indicators	Statistical data about country's economy, such as unemployment figures, the Consumer Price Index (CPI), Gross Domestic Product (GDP), money supply and housing statistics. This data gives information about the future direction of output and demand in an economy.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exchange Rate	The value of one country's currency expressed in terms of another.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Fix	The setting of a currency or commodity price for trade at a future date.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They mainly comprise tangible assets, such as land and equipment.
Fixed Capital	Fixed capital is the part of a company's total capital that is invested in fixed assets such as land, buildings and equipment that remains on the balance sheet, usually for years, but for at least one accounting period.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
Goodwill	Arises upon the sale/acquisition of a business and is defined as an established entity’s reputation, which may be regarded as a quantifiable asset and calculated as the price paid for a company over and above the net value of its assets. Negative goodwill refers to a situation when the price paid for a company is lower than the value of its assets.
Hedge	A form of insurance against financial loss or other adverse circumstances.
Income Statement	A summary of all the expenditure and income of a company over a set period.
Institutional Investors	Financial institutions such as pension funds, asset managers and insurance companies, which invest large amounts in financial markets on behalf of their clients.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest Leakage	Situation whereby a company has outstanding debt that yields a higher interest cost than the interest earned on cash balances.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Interest Rate Risk	The potential for losses or reduced income arising from adverse movements in interest rates.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.

Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Mandate	Authorisation or instruction to proceed with an undertaking or to take a course of action. A borrower, for example, might instruct the lead manager of a bond issue to proceed on the terms agreed.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
National Scale Rating	The national scale provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account such as interest, tax, depreciation, auditors' fees and directors' fees.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Margin	Operating margin is operating profit expressed as a percentage of a company's sales over a given period.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Option	An option gives the buyer or holder the right, but not the obligation, to buy or sell an underlying financial asset at a pre-determined price.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Prepayment	Any unscheduled or early repayment of the principal of a mortgage/loan.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or "'Evolving' (the rating symbol may be raised or lowered).
Receivables	Any outstanding debts, current or not, due to be paid to a company in cash.
Refinancing	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
Return On Equity	Return on equity, or ROE, is the ratio of a company's profit to its shareholders' equity, expressed as a percentage. It is the most widely used measure of how well management uses shareholders' funds. Its main advantage is that it is a benchmark that allows investors to compare the profitability of companies in different industries.
RevPAR	Revenue per available room-a ratio used to determine a hotel's performance, which also allows for comparisons across various assets.
Risk	The possibility that an investment or venture will make a loss or not make the returns expected. There are many different types of risk including basis risk, country risk, credit risk, currency risk, economic risk, inflation risk, liquidity risk, market or systemic risk, political risk, settlement risk and translation risk.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Secondary Market	The secondary market is where securities are bought and sold once they have been issued in the primary markets. The secondary market gives a continuing opportunity for buying and selling and price discovery, and provides the liquidity that allows the primary market to function.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.
Turnover	The total value of goods or services sold by a company in a given period. Also known as revenue or sales. Turnover can also refer to the total volume of trades in a market during a given period.
Working Capital	Working capital usually refers to the resources that a company uses to finance day-to-day operations. Changes in working capital are assessed to explain movements in debt and cash balances.

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SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

TPS Eastern Africa Plc participated in the rating process via face-to-face management meetings, teleconferences as well as written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to TPS Eastern Africa Plc with no contestation of the ratings.

The information received from TPS Eastern Africa Plc and other reliable third parties to accord the credit ratings included:

- the 2017 audited annual financial statements and four years of comparative numbers;
- detailed 2018 financial budgets;
- management accounts for the two months to 28 February 2018; and
- a breakdown of facilities available and related counterparties.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.