Ratings Methodology – Hotel Industry

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CareEdge RATINGS AFRICA
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Industry overview

The Mauritius hospitality industry along with tourism has been one of the key segments driving the growth of the services sector in the Mauritian economy. As of third quarter ending September in 2025, there were a total of 110 licensed hotels in Mauritius with total room capacity of the hotels in operation was at 13,555 with 30,330 bed places. The industry is driven by macroeconomic factors like the prospects of the global tourism industry (which, in turn, is dependent on the overall economy and disposable income), the competitiveness of aviation sector connecting various geographies, business and leisure travel, foreign tourist arrivals (FTAs) and the trend of meetings, incentives, conferences, and exhibitions (MICE).

In CareEdge Africa (CRAF) view, the risk profile associated with the hotel industry is high given the fact that the industry is highly seasonal as well as cyclical in nature and exhibits high volatility in its revenue and profitability depending on the economic cycle. During the economic boom, the industry is positively impacted and witnesses higher spending and better margins backed by healthy operational parameters, while in the case of economic downtrends, the industry is adversely impacted and struggles in terms of revenue and profitability. The fact that the industry is characterized by high capital cost, coupled with long gestation period also puts pressure on its cash flows in times of economic downtrends.

Rating Methodology

CRAF has a well laid-out methodology for the rating of entities belonging to the service sector. CRAF's rating process begins with the evaluation of the economy/ industry in which the entity operates, as well as the assessment of the business risk factors specific to the entity. This is followed by an evaluation of the financial and project-related risk factors as well as the quality of the management. This methodology is adopted while analysing all entities that come under the purview of the service sector. However, considering the size and diversity of each sector, CRAF has developed methodologies specific to various sectors. These methodologies attempt to point out factors, over and above those mentioned in the broad methodology, which will be assessed while determining rating of entities belonging to the particular industry. The following is a list of such additional factors, along with their analytical implications, considered by CRAF while arriving at the rating of the players that operate in the hotel sector.

A. Promoters/Management Analysis

Experience and market image of the promoters are given utmost importance while evaluating management competency and quality. CRAF assesses management's ability to run the business efficiently while addressing the inherent business risk associated with hotel operations and undertake judicious expansion activities. Considering the capital-intensive nature of the hotel business, a company with financially strong promoters enjoys an advantage over others as its ability to infuse and/or raise funds in a timely manner is crucial. The rating methodology for hotel companies also lays considerable stress on the commitment of the promoters not only in the form of initial equity infusion but their ability to continuously support during the initial years of operations for loss funding and debt servicing if needed along with their active involvement in the operations of the company given the fact that hotels have a long gestation period.

B. Business Risk Analysis

i. Evaluation of business model

Hotels can be owned/leased, franchised or managed. A healthy mix of revenue from different business models would be favourable from a credit perspective. Selection of business model depends on how experienced and financially equipped a promoter is to independently own and operate a hotel under own brand.

ii. Brand strength

CRAF favourably views hotels operated under the renowned and established brands as it helps in higher visitation leading to better revenue visibility and maintaining market share even in increasing competitive scenario. Operational risk is lower in hotels operated by a renowned hotel chain vis-à-vis hotels operated by a hotel operator/owner with little or no prior experience in operating hotels.

iii. Scale

While assigning the rating, CRAF considers the scale of business operations in terms of room inventory and other infrastructure. In CRAF view, the scale of operations is an important rating consideration as it provides the entity with competitive advantages such as economies of scale with better absorption of fixed cost and better bargaining power with suppliers as well as its customers.

iv. Revenue diversification

While scale provides a hotel with various competitive advantages, it is diversification which ensures the stability of cash flows. CRAF views companies with geographical diversification with a large number of properties more favourably as compared to companies with a single property.

CRAF also analyses the revenue concentration of an organization in terms of customer type, region or service type. The industry is composed of three sub-segments, viz, luxury/upscale segment; mid-scale segment and economy/budget segment. Revenue per available room (RevPAR) of luxury/upscale segment is more vulnerable to cyclicality vis-à-vis RevPAR of mid-scale and economy hotels. However, during high demand, the luxury/upscale segment has higher pricing flexibility as compared with mid-scale and economy hotels. While analysing hotel companies, CRAF examines their presence in various sub-segments. Companies with a presence in multiple sub-segments have higher business stability. As they cater to different customer segments across various price points, they enjoy a larger customer base.

v. Operational performance

CRAF analyses performance indicators of hotels such as ARR (Average Room Rent), Occupancy ratio and RevPAR (Revenue Per Available Room). RevPAR is a derivation of ARR and Occupancy levels, which are, in turn, dependent on many factors like location, demand-supply dynamics, brand, sub-segment, economic scenario and others. For an operational hotel, CRAF evaluates movement in RevPAR in the past and the ability of a hotel to charge ARR at a premium over industry ARR without compromising on occupancy levels. CRAF also evaluates the mix of revenue from room rent vis-à-vis food and beverage (F&B) /banqueting and their interdependence.

vi. Location analysis

The location of the property portfolio is important in determining the volatility and relative level of a hotel's earnings. The strategic location of a property near a place of interest/commercial area helps attract more and repeat customers and is viewed positively. At the same time, competing properties in the vicinity would tend to exert pressure on pricing.

The properties can be categorised as business and leisure destinations. At times, the two are not mutually exclusive as some locations have a fair mix of business and leisure travellers. The demand dynamics are quite different for both segments. Properties located in leisure destinations are likely to have significant seasonality in occupancies and ARR and high gestation period. Similarly, the chains with a higher dependence on foreign travellers are likely to be affected more severely during extraordinary events like economic slowdown, terrorist attack and other events. Location at gateway cities, key business centres and popular leisure destinations may provide some buffer during periods of economic slowdowns as occupancies may not decline as sharply.

B. Financial Parameters

I. Revenues & Profitability

In the case of a hotel company, degree of stability to revenues and profits is of high importance. Healthy sales and profitability are a direct derivation of higher RevPAR. Higher RevPAR indicates strong market positioning of the hotel, whereas healthy profitability reflects the ability to generate cash accruals to support business operations and fund ongoing maintenance, expansion if any. Revenue and profitability in the sector are seasonal as well as cyclical in nature and CRAF takes the same into cognizance. While revenue is skewed towards the second half of a year, expenses are spread more evenly impacting the profitability. Furthermore, during the economic boom, the industry is favourably impacted by higher disposable income while the same struggles during economic downturns.

II. Leverage and Debt Servicing

The hotel industry is highly capital intensive and is characterized by a long gestation period. Hotel entities also continuously invest in up-gradation and expansion to remain competitive in the industry. Therefore, CRAF evaluates the capital structure of a hotel entity to determine its ability to service the debt and also evaluate its financial flexibility. The extent of leveraging determines the possible level of stress on operational cash flows, particularly in cyclical downturns. CRAF while computing the leverage also factors the lease liabilities as part of total debt. High leverage reduces financial flexibility of a hotel company, thereby, its fund-raising ability in case of any future capex plans or any shortfall in cash flows during adverse market conditions.

CRAF evaluates total debt position vis-à-vis level of gross cash accruals to ascertain the adequacy of its cash flows to service debt repayment obligations. Furthermore, while evaluating future cash flows, capex requirement (usually for new properties and renovation of existing properties) and its funding pattern are also factored in. Given the fact that hotel entities have high initial investment and long gestation periods, repayment schedules of longer tenor so that they are mapped adequately with the expected cash flow of the hotel to avoid any liquidity stress are preferred. Any significant interest rate change may have an impact on the debt servicing capabilities of hotel entities and the same is considered in the analysis by CRAF.

During economic downturns, the companies with lower financial leverage may be able to withstand some moderate weakening in operational performance due to relatively lower debt servicing requirement and a relatively better financial flexibility.

C. Project Risk

Some additional factors are accounted for while rating companies that are in the project stage or are undergoing expansion. CRAF considers the management's past track record of executing projects with a judicious mix of debt and equity components and without any cost/time overruns as a critical factor. The facilities being offered, the competitive positioning, relative cost structure, capital cost per room, funding sources, debt structure of the project and accessibility of various sources of funding are assessed. The hotel industry is cyclical and projects have a long gestation period; hence, the timing of setting up a new hotel or expansion is of critical importance.

While examining new/expansion plans, CRAF evaluates the rationale of the project, its strategic importance in the company's business plan, marketing-cum-management tie-up and the magnitude of the project vis-à-vis the net worth/asset size of the company. CRAF also evaluates the location demand-supply situation at the time of project completion and analyses its impact on the company's financials and future cash flows. In the case of inorganic growth, CRAF analyses the cost of acquisition vis-à-vis benefits of synergies. While examining an ongoing project, CRAF examines the stage of approvals, licences, governmental clearances agreements with contractors and consultants and their impact on the possibility of time and cost overrun.

Conclusion

The rating outcome is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. CRAF analyses each of the above factors and their linkages to arrive at the overall assessment of credit quality by taking into account the industry's cyclicality. While the methodology encompasses comprehensive financial, commercial, economic, and management analysis, the credit rating analysis is ultimately an overall assessment of all aspects of the issuer focussed on assessing timely debt servicing ability of the issuer

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About:

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