

SMART RESIDENCES LIMITED

Final 2023 Corporate Rating Review Report



Research, Credit Ratings, Credit Risk Management

SMART RESIDENCES LIMITED

Issuer Rating:

Bbb-

A company with satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due relative to all other issuers in the same country.

Outlook: Stable

Issue Date: 6 October 2023

Expiry Date: 30 June 2024

Previous Rating: **Bbb-**

Industry: Hospitality

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RATING RATIONALE

Agusto & Co hereby affirms the “**Bbb-**” rating assigned to (“Smart Residences”, “SRL” or “the Company”). The affirmed rating reflects our opinion on SRL’s good profitability metrics upheld by robust growth in its operating scale and its relatively sturdy ability to pass on cost increases to its customers to preserve margins and strong cash flow position upheld by sustained net earnings growth. The rating also considers Smart Residences’ good position in the Flexible Accommodation segment of the Nigerian Hospitality Industry, improving fundamentals of the domestic tourism sector, which is positively influencing demand for affordable and flexible accommodation options and its adequate working capital position. Nevertheless, the rating is tempered by SRL’s elevated leverage metrics, concerns over its concentrated ownership structure, the susceptibility of its operations to external shocks such as rising energy and other operating costs due to higher inflationary pressures and the potential adverse impact on profit margins.

Smart Residences Limited is a hospitality and real estate firm that operates in the Federal Capital Territory, Abuja. SRL was established during the height of the COVID-19 pandemic in 2020 and offers serviced short-term rental apartments to corporate and individual clients. The Company’s principal revenue sources are rental inflows on apartments, food and beverages sold to customers and event hosting income. Smart Residences Limited commenced operations with a portfolio of 30 leased apartments, and within its first two years of operation, it successfully doubled that number. Smart Residences currently manages three leased properties - The Residences, The Glass Residences and The Destination all under a 10-year lease agreement, while the fourth (The Home Away) is currently under renovation and is scheduled to become operational in November 2023.

In the financial year ended 31 December 2022 (FYE 2022), the Company recorded a significant 241% year-on-year growth in revenue to ₦1.6 billion, mainly supported by its increased operating scale, upward price reviews and the sustained demand for flexible accommodation buoyed by election-related activities. In the same year, SRL’s direct cost-to-revenue ratio inched up to 28.5% (2021: 21.5%) amidst higher

inflationary pressures on the prices of food and other key inputs, translating to a gross profit margin of 71.5% (2021: 78.5%). However, Smart Residences' operating profit margin (OPM) rose to 41% in FYE 2022 (2021: 36.7%) due to better management of operating costs in the year and was well above our internal benchmark of 20%. Overall, SRL posted a lower pre-tax-pre-interest return on assets (ROA) of 13% (2021: 20%) due to the addition of The Destination apartments to its operations, which ballooned its asset base while the pre-tax return on equity ratio stood at 46% (2021: 30%). The aforementioned ratios were in line with our expectations, giving credence to SRL's good profitability position in our view.

In the review period, Smart Residences posted an operating cash flow (OCF) of ₦1.3 billion (2021: ₦469 million) to reflect the growth in net earnings. The OCF, which represented 78% of revenue was more than sufficient to cover the returns to providers of finance (RTPOF) of ₦108 million, which was good in our opinion. Given the Company's increasing operating scale, which should translate to sustained net earnings growth, we expect its cash flow position to remain good in the near term.

The Company's spontaneous financing as at FYE 2022 was insufficient to cover its trading assets, leaving a working capital need of ₦413 million. Nonetheless, Smart Residences Limited's long-term funds as at FYE 2022 were sufficient to cover the long-term assets, resulting in a working capital available of ₦1.1 billion. Thus, Smart Residences Limited recorded an overall working capital surplus of ₦687 million as at FYE 2022. Augusto & Co. considers the Company's working capital to be adequate.

Smart Residences Limited obtained ₦1.3 billion in bank borrowings in FYE 2022 to finance the renovation of 'The Destination' and 'The Home Away' properties and to meet the rising working capital requirements on account of its expanding operations. This in addition to the lease liabilities recognised on 'The Glass Residences' and 'The Destination' resulted in a sharp rise in SRL's total liabilities to approximately ₦2.8 billion (2021: ₦228 million) and comprised lease liabilities (48%) interest-bearing liabilities (47%) and non-interest-bearing liabilities (5%). On the back of the incremental borrowings and higher funding costs in the year, SRL's interest-expense-to-sales ratio soared to 6.7% in 2022 (2021: NIL) and exceeded our threshold of 5%. Similarly, SRL's net debt (total liabilities less cash and equivalent) to total assets and interest-bearing liabilities to equity ratios rose to 116% (2021: 45%) and 78% (2021: NIL) respectively, underscoring its high leverage position in our opinion.

Looking ahead, Management intends to diversify its earnings base by tapping into the considerable opportunities in the Real Estate Industry by entering into joint venture arrangements to construct furnished apartments for its high-end clientele base and also offering facility management services in the near term. The Company believes the combination of the aforementioned initiatives will result in sustained improvements in its financial condition in the near term.

Therefore, we attach a **stable** outlook to Smart Residences Limited.

Figure 1: Company's Strengths, Weaknesses, Opportunities and Challenges

<p>Strengths</p> <ul style="list-style-type: none"> Stable and qualified management team Good profitability metrics Good cash flow position Adequate working capital
<p>Weaknesses</p> <ul style="list-style-type: none"> Concentrated ownership structure High leverage metrics
<p>Opportunities</p> <ul style="list-style-type: none"> Nigeria's large population and expanding business sector Improving fundamentals of the domestic tourism market
<p>Challenges</p> <ul style="list-style-type: none"> Sustained spike in remodelling costs amid rising prices of construction materials Increasing competition from other local and international operators Weak macroeconomic indicators and the adverse impact on occupancy rates Rising energy costs and its attendant impact on profit margins

PROFILE OF SMART RESIDENCES LIMITED

Smart Residences Limited (“Smart Residences”, “SRL”, or “the Company”) was incorporated on 8 May 2019 and commenced full operations in January 2020 as a flexible accommodation and unique hospitality service provider in Nigeria. The Company’s principal business activities involve the provision of serviced short-let apartments to corporate clients, individuals and tourists who require decent, comfortable and home-like accommodation to live for a short period. The Company operates through two trademarks– “Gidanka” (associated with its three apartments in operation “The Residence”, “The Glass Residence”, and “The Destination”) and “Home-Away”, which is currently undergoing renovation, all located in the Federal Capital Territory, Abuja. The Residence contains 30 units split into 14 basic studio apartments, four each of standard studio, executive studio, standard one-bedroom and deluxe one-bedroom apartments. The Glass Residence consists of five units of each of these categories, while The Destination, launched in December 2022, contains 110 units of apartments, workstations and two meeting rooms. The Company’s three serviced apartments are strategically situated in Katampe Extension, Diplomatic Zone, Jabi, and Aminu Kano, Wuse 2 in Abuja. These apartments are leased for a duration of 10 years, enabling SRL to adapt to evolving client preferences by moving to new locations when necessary. This distinctive approach sets the Company apart from conventional hotels, as it aims to continually offer clients desirable locations and flexibility.

Smart Residences Limited’s core business strategy revolves around providing clients with accommodations that blend the comforts of home with the luxury services associated with hotels. Smart Residences Limited’s apartments are designed to mirror the characteristics of upscale, fully functional residences, complete with kitchen facilities and utensils, dining amenities, internet connectivity, televisions, laundry services, toiletries, and more. The Company undertakes the refurbishment and remodelling of residential properties acquired through leases from landlords, realtors and developers. These properties are remodelled into furnished spaces, encompassing self-contained studio apartments, standard, deluxe and executive one-bedroom apartments, all housed within Smart Residences’ facilities. Each of these apartments is designed to meet different clients’ needs as well as the nature and style of the neighbourhoods, thus providing Smart Residences’ customers with multiple choices that suit their individual preferences and tastes. The selection of the Company’s apartment locations is guided by market research, pinpointing neighbourhoods favoured by travellers and tourists. This method enables SRL to strategically establish apartments in areas where demand is strong, thereby providing an avenue for the Company to expand and scale up operations faster than an average hotel or other hospitality service providers with fixed buildings and properties.

SRL’s apartments are typically powered with a combination of national grid electricity supply, inverter and diesel generators. The Company relies on a single supplier for its diesel needs, albeit with an agreed minimum volume and guaranteed price, typically settled in arrears according to the contract terms. Smart Residences Limited’s apartments are booked via two online platforms namely: “Tripadvisor” and “Booking.com”. As disclosed by management, Smart Residences Limited’s projects typically take between four to six months from signing a lease on the building to completing the remodelling and becoming available for rental to clients.

OWNERSHIP, GOVERNANCE, MANAGEMENT & STAFF

As at 31 December 2022, Smart Residences Limited's authorized, issued and fully paid-up share capital remained unchanged at ₦1 million made up of 1 million ordinary shares at ₦1 each. As at the same date, Safe Xchange Limited controlled the majority of the Company's equity (80.5%) while Mr Olajide and Mr Ande Ibrahim are the other shareholders with up to 5% ownership interest. Mr Olajide Abiola controls 47.8% of the equity of Safe Xchange Limited, while the balance of 52.2% was split amongst other shareholders¹. Subsequent to FYE 2022, Smart Residences Limited's authorized, issued and fully paid-up share capital rose to ₦100 million made up of 100 million ordinary shares at ₦1 each, with the shareholdings remaining unchanged. In our opinion, the Company's ownership structure is highly concentrated.

As at the end of FYE 2022, Smart Residences Limited had an eight-member Board of Directors, comprising four independent non-executive directors, three non-executive directors and one executive director. Mr. Eric Oyiboka leads the Board as Chairman while Mr. Olajide Abiola is the Chief Executive Officer. Smart Residences Limited's Board members met five times in the year under review. Augusto & Co. recognises positively that the composition of SRL's Board is skewed towards non-executive directors, which complies with the principles enshrined in Nigeria's Corporate Governance Codes. We also note that most members of SRL's Board possess vast experience in the Hospitality Industry both in Nigeria and abroad. The Company's Board operates through three committees - the Nominations and Governance Committee, the Audit and Risk Committee and the Finance Committee. The Nominations and Governance Committee comprises seven members and is led by Mr Usman Idris Alihaji as the Chairman, Mr Temitope Ajayi, an Independent Non-Executive Director leads the Audit and Risk Committee with six other members while Mr Umar Idris Musa is the Chairman of the seven-member Finance committee.

Table 1: Current Members of SRL's Board of Directors

Name	Designation
Mr. Eric Oyiboka	Chairman
Mr. Olajide Abiola	Chief Executive Officer
Mr. Omeiza Ohani	Non-Executive Director
Mr. Aminu Aliyu	Non-Executive Director
Mr. Ajayi Temitope	Independent Non-Executive Director
Umar Idris Alihaji	Independent Non-Executive Director
Mr. Umar Idris Musa	Independent Non-Executive Director
Mrs. Funmilola Oyewole	Independent Non-Executive Director

Source: Smart Residences Limited's Management Presentation

Smart Residences Limited's management team consists of the Chief Executive Officer and four senior management personnel overseeing the Company's Finance, Operations, Strategy and Project Management functions. Augusto & Co. notes that most of the management team have vast experience in real estate and hospitality industries within and outside Nigeria with relevant qualifications and have been with the Company since inception, depicting a stable and qualified management team in our view.

¹ *Udoh One Thaddeus (13.3%), Anyadike Chiemeziem (12.3%), Alaya Sally Tajudeen (6.7%), Adebiji Mikail Olumuyiwa (5%), Ishola Daniel Oluwakayode (5%), Ogbole Ajina Caroline (4.3%), Them Maryam Dulcit (3.3%) and Jiwul Blessing Jahota (2.3%).*

Management Team

Mr Olajide Abiola is the Founder and Chief Executive Officer of Smart Residences Limited. Mr Olajide has over nineteen years of work experience in hospitality, real estate and fintech services. He is also the founder and a non-executive director of “Kiakia”, a digital micro-lending platform that grants access to personal and business loans to individuals, through its artificial intelligence, automated credit scoring and risk assessment models. Mr Olajide is an entrepreneur with business interests in hotels and hospitality, real estate, fintech and agriculture and provides overall strategic leadership, direction and guidance for the business.

Mr Abiola is a former military officer who commenced his career in the Nigerian Army as an administrative assistant and field officer in 2001. Following his military service, he took on the role of Legislative Aide to the Senate Chairman of the Committee on Banking, Insurance, Other Financial Institutions, and the Capital Markets from 2011 to 2015. Mr Olajide currently serves as a non-executive director on the Boards of Wheat Genius Limited, NFGCS Farms Limited and KiaKia. His educational background includes a Certificate in Essential Skills and Strategies of Negotiation from the University of Michigan, as well as a Bachelor of Science degree in Computer Science from the University of Ilorin.

Table 2: Other members of SRL's management team

Name	Position
Adesoba Adebayo	Chief Financial Officer
Aliyu Hassan Aminu	Chief Operating Officer
Tomiwa Tunde	Head of Strategy
Chima Nwanjufor	Operations Manager

Source: Smart Residences Limited

As at 31 December 2022, Smart Residences had a staff strength of 27 employees (2021: 28 employees). The Company's average cost per employee stood at ₦2 million as at FYE 2022 (2021: ₦1 million), while contribution per employee (measured as operating profit adjusted for staff cost) rose by 263% to approximately ₦27 million mainly on the back of the higher revenue generated during the year. The average contribution per employee was sufficient to cover the average cost per employee 11.2x, thus depicting a good staff productivity level in our view.

FINANCIAL CONDITION

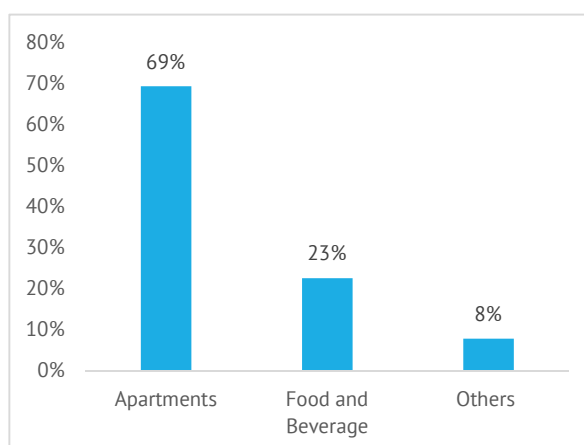
Analysts' Comments: We have analysed the audited financial statements of Smart Residences Limited for the three years ended 31 December 2022 and unaudited management accounts for the period ended 30 June 2023.

PROFITABILITY

The Nigerian Hospitality Industry continued its post-pandemic recovery in 2022, following the gradual transition from virtual and hybrid arrangements to physical meetings and events. As a result, most operators experienced a considerable uptick in occupancy rates in 2022 driven mainly by pent-up demand amid the increase in tourist and travel activities. With the sustained improvements in the Industry's fundamentals, the Company launched 'The Destination' in December 2022, which contains 110 units of apartments, workstations and two meeting rooms as well as food and beverage spots in line with its long-term strategy to deepen its value proposition to customers.

In the financial year ended 31 December 2022, Smart Residences Limited reported a total revenue of ₦1.6 billion, up by a substantial 241% from the previous year. Revenue growth was driven by the positive impact of the addition of 'The Glass Residences' apartments on SRL's operations, inflation-induced pricing adjustments in the year² and the higher occupancy rates supported by the increased electioneering and travel activities. A delineation of SRL's earnings showed that income from apartment bookings accounted for 69% of the FYE 2022 revenue, while inflows from food and beverage and others (mainly rental income on event centres) constituted 23% and 8% respectively. We consider Smart Residences' increased operating scale and good ability to pass on cost increases to customers to preserve profit margins as bright spots for the Company. As a result, we expect sturdy improvements in SRL's revenue-generating capacity in the near to medium term.

Figure 2: FYE 2022 Revenue Breakdown

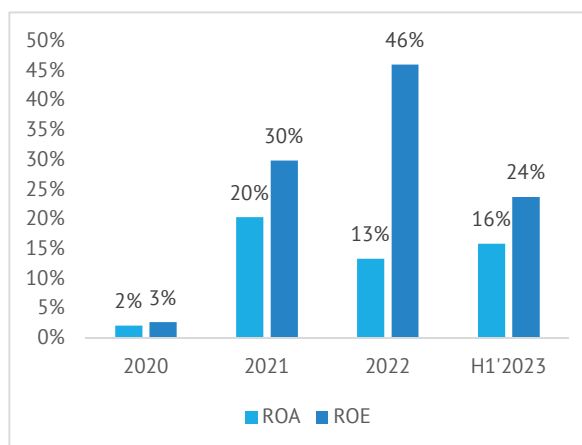


In the review period, Smart Residences' direct costs grew in tandem with revenue to approximately ₦349 million from the ₦45 million reported in the previous year. Consequently, Smart Residences' direct cost-to-revenue ratio surged to 21.5% in the review period (2021: 9.5%), translating to a much lower gross profit margin of 78.5% (2021: 90.5%). In FYE 2022, SRL's operating expenses rose by 137% in absolute terms to ₦606 million to reflect the increased operating scale and higher inflationary pressures on personnel costs, electricity charges, generator running expenses and repairs and maintenance. Notwithstanding, SRL's operating expense to sales ratio improved to 37.5% in 2022 (2021: 53.8%), translating to a better operating profit margin (OPM) of 41% (2021: 36.7%), mainly supported by the enlarged earnings base, which we view positively. The Company's OPM of 41% in 2022 and three-year (2020-2022) weighted average operating margin of 34% were better than our internal benchmark for operators in the Industry. While we expect an uptick in SRL's cost structure on account of its expanded operating scale, rising energy costs and the impact of higher inflationary pressures on food and other inputs, we note that its relatively strong ability to implement regular pricing adjustments will continue to uphold its profit margins.

² Smart Residences implemented an average price increase of 25% in FYE 2022

In the year under review, Smart Residences Limited posted earnings before interest, tax, depreciation and amortisation (EBITDA) margin of 48% (2021: 63%), which we consider good. Similarly, the Company’s three-year (2020 – 2022) weighted average EBITDA margin of 46% also outstripped our internal benchmark. In 2022, Smart Residences Limited obtained a ₦1.3 billion facility from a commercial bank to fund its expansion initiatives, particularly the launch of ‘The Destination’ apartments. As a result, the Company reported an interest expense of ₦108 million (2021: NIL), resulting in an interest expense to sales ratio of 6.7%, which was higher than our threshold of not more than 5%. Management has disclosed that there are currently no plans to obtain additional borrowings in the near term. Notwithstanding, we take cognisance of the rising interest rate environment in the country in FYE 2023 as the Central Bank of Nigeria continues to raise the benchmark interest rate to tackle the persistently high inflationary pressures in the country. As such, we expect the interest expense-to-sales ratio to maintain its upward trend in FYE 2023. Against the backdrop of the higher financing costs, the Company’s pre and post-tax margins in 2022 dipped to 22.7% (2021: 30.7%) and 16.9% (21.5%) respectively.

Figure 3: ROA & ROE (2020 - H1'2023)



Despite the much-improved operating performance in the year, Smart Residences pre-tax-pre-interest return on assets (ROA) moderated to 13% from the 20% posted in the previous year to reflect the increase in its asset base following the addition of ‘The Destination’ to its operations. However, SRL’s 2022 pre-tax-pre-interest return on assets of 13% and three-year (2020 – 2022) weighted average ROA of 14% were both in line with our benchmarks. In FYE 2022, Smart Residences’ pre-tax return on equity (ROE) inched up to 46% (2021: 30%) and provided a reasonable premium above the average yield on 365-day treasury bills and the inflation rate of approximately 10% and 19% respectively over the same period, which we consider to be good. The Company’s three-year (2020 – 2022) weighted average ROE of 38% was also good in our opinion.

As a result of the cash crunch stemming from the Naira redesign policy and election-induced uncertainties, the Company’s unaudited accounts for the six months ended 30 June 2023 showed revenue of approximately ₦1.1 billion, which represented 41% of the FYE 2023 projections. Notwithstanding, the gross and operating margins remained strong at 71.5% and 39.1% respectively. The annualised ROA and ROE also remained good at 16% and 24% respectively. Management expects the Company’s occupancy rate, which stood at 73% as at the half year 2023 (2022: 68%) to continue its upward momentum mainly on the back of the favourable fundamentals in the Industry and the improving prospects of the domestic tourism space. Furthermore, with the upcoming festive season, we reckon that the prospects of SRL and indeed the Hospitality Industry, in general, are poised to benefit from the uptick in social events and increased need for flexible accommodations. Based on the foregoing, we expect the Company’s overall profitability metrics to remain good in the near term.

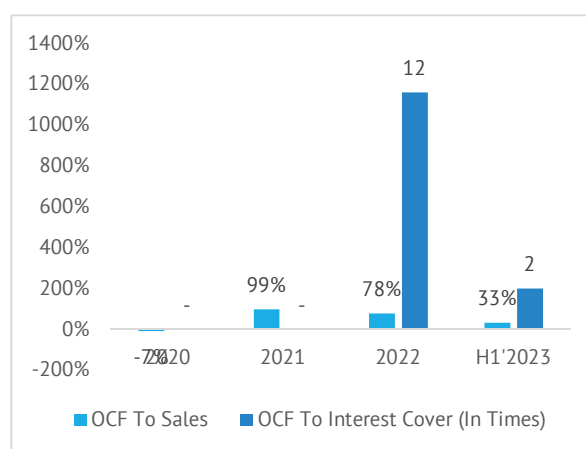
In our view, Smart Residences Limited’s overall profitability is good.

CASH FLOW

Smart Residences Limited generates cash principally from rental income earned from leasing its apartments to corporate and individual clients. Reservations for SRL’s flexible apartments are conducted via its website and third-party (Tripadvisor and Booking.com) platforms and as such, rental fees are usually received in cash at the point of booking although we note that the third-party platform typically remits rental fees after 2 weeks. In the same vein, Smart Residences Limited also grants credit periods ranging between 2 weeks to 1 month to its well-known customers. As a result of the foregoing, the Company experienced a considerable spike in its trade receivables collection period to 55 days in FYE 2022 from the 1 day reported in the previous year.

In the review period, Smart Residences Limited recorded an operating cash flow (OCF) of approximately ₦1.3 billion, a significant improvement from ₦469 million in 2021 mainly supported by the notable growth in net earnings. The Company’s operating cash flow in FYE 2022 was more than sufficient to cover interest payments to debt financiers of ₦108 million (no dividend was paid to shareholders in the same period). This translated to an interest cover of approximately 12x, which was significantly better than our benchmark of 3x thus depicting a very good repayment capacity in our opinion. Furthermore, the net OCF (after interest payments) was also sufficient to cover the mandatory capital expenditure of ₦76 million, which we view positively. Similarly, the Company’s three-year (2020 – 2022) cumulative OCF of ₦1.7 billion was sufficient to cover cumulative interest payments of ₦180 million over the same period.

Figure 4: OCF To Sales & Interest Cover (2020 - H1'2023)



In the year under review, Smart Residences Limited’s operating cash flow constituted 78% of revenue (2021: 99%) and was well above our benchmark of 20%, underscoring our opinion of its very good cash-generating capacity, which we expect to be sustained in the near term. In the same vein, over the past three years (2020 – 2022), SRL’s operating cash flow to sales ratio stood at 78%, which we consider to be very good.

Due to the impact of rising inflationary pressures on the prices of food and other key inputs in the country, Management opted to increase its inventory investments to lock in prices and guarantee availability to minimise disruptions to its operations. As a result of the foregoing, coupled with an uptick in trade receivables, Smart Residence reported a much lower OCF of ₦362 million in the first half of 2023, which represented 36% of sales in the same period. Notwithstanding, the OCF was sufficient to cover the interest payments of ₦180 million, which we consider to be satisfactory. In the medium term, we expect the cash flow position to be supported by the Company’s continued expansion in the Flexible Accommodation space.

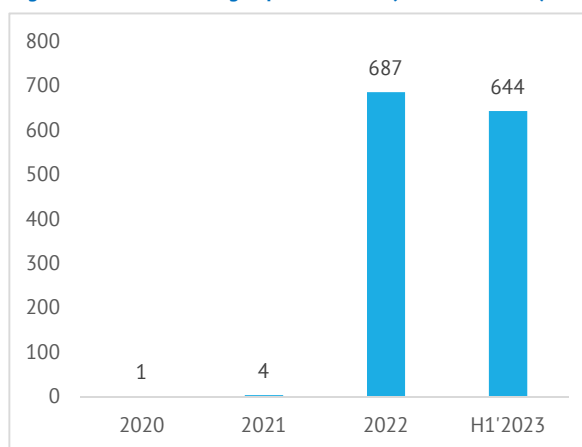
In our opinion, Smart Residences Limited’s overall cash flow position is good.

FINANCING STRUCTURE AND ADEQUACY OF WORKING CAPITAL

As at 31 December 2022, Smart Residences Limited’s trading assets rose to ₦556 million (2021: ₦5 million), primarily due to the increased inventory investments to hedge against price fluctuations of key inputs in addition to a much higher trade receivables balance compared to the previous year. As at the same date, inventories represented 56% of trading assets while trade receivables constituted the balance of 44%. As at FYE 2022, the Company’s spontaneous financing (non-interest-bearing liabilities) rose by 55% to ₦143 million largely on account of the growth in taxation payable and other accruals. The spontaneous financing comprised taxation payable (52%), other accruals (27%) and trade creditors (21%). The Company’s spontaneous financing as at FYE 2022 was insufficient to cover the trading assets, leaving a working capital need (WCN) of ₦413 million as at the same date. Considering the Company’s strategy of sustaining inventory investments in the medium term, we expect the working capital need to persist going forward.

As at 31 December 2022, Smart Residences Limited’s long-term assets surged by 229% to ₦2.3 billion, in tandem with the expanding operating scale while its long-term funds, which comprised lease liabilities (39%), long-term borrowings (38%) and equity (23%) amounted to ₦3.4 billion. Smart Residences’ long-term funds were sufficient to cover the long-term assets, leaving working capital available of ₦1.1 billion. The working capital was sufficient to cover the working capital need, resulting in an overall working capital surplus of ₦687 million, which was similar to the previous year.

Figure 3: Overall Working Capital Position (2020– H1'2023)



As at 30 June 2023 unaudited management accounts, Smart Residences Limited recorded a working capital need and working capital available of ₦456 million and ₦1.1 billion respectively, translating to an overall working capital surplus of approximately ₦644 million. Moving ahead, we project that the Company’s expanding operating scale will have a positive impact on its working capital position via increased profit accretion to retained earnings in the near term. Furthermore, we also project that the recapitalisation of the business in the first half of 2023, which increased SRL’s equity will support its overall working capital position.

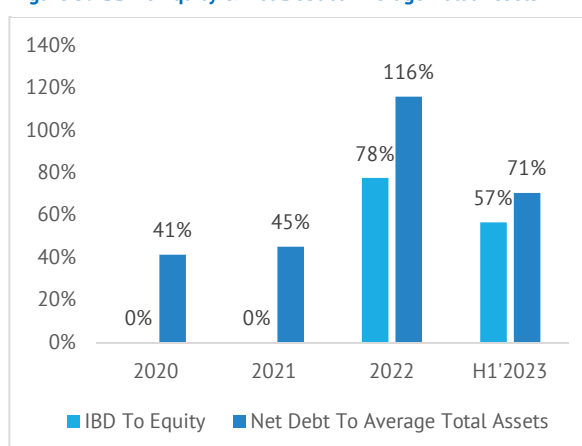
In our opinion, Smart Residences Limited’s working capital is adequate for its current business operations.

LEVERAGE

As at December 2022, Smart Residences' total liabilities grew sharply to approximately ₱2.8 billion (2021: ₱228 million) mainly on account of lease liabilities recognised on 'The Glass Residences' and 'The Destination' apartments in addition to a three-year loan obtained from a commercial bank at an interest rate of 29%. The bank borrowings are being used to finance SRL's ongoing expansion efforts – 'The Home Away' apartments - and to meet the higher working capital requirements. As at the same date, Smart Residences' total liabilities were split into lease liabilities (48%) interest-bearing liabilities (47%) and non-interest-bearing liabilities (5%).

As a result of the incremental borrowings and the high-interest rate environment in the review period, Smart Residences Limited reported an interest expense of ₱108 million (2021: NIL). Thus, the Company reported an interest expense-to-sales ratio of 6.7% in FYE 2022, which outstripped our internal benchmark of not more than 5%. Given the persistent hikes in the benchmark interest rate by the apex bank amidst the sustained inflationary pressures in the country, Agosto & Co. projects that the interest-expense-to-sales ratio will remain elevated in FYE 2023. However, in FYE 2022, Smart Residences Limited posted an interest coverage ratio of approximately 12x, which was better than our benchmark of 3x.

Figure 5: IBD To Equity & Net Debt to Average Total Assets



As at FYE 2022, the Company's financing structure was more skewed towards debt funding with non-interest-bearing liabilities (largely lease liabilities relating to the Glass Residences and The Destination apartments) constituting (41%), interest-bearing liabilities (37%) and equity (22%) compared to the previous year wherein equity accounted for 68% and non-interest-bearing liabilities (32%). The Company's funding structure in FYE 2022 depicts a low equity cushion in our view. Following the introduction of bank borrowings to its capital structure, SRL's interest-bearing debt-to-equity ratio rose sharply to 78% as at FYE 2022 (2021: 1%), while its net debt-to total asset ratio as at the same date worsened to 116% (2021: 20%), underscoring its high leverage position in our opinion.

As at 30 June 2023 (unaudited), the Company's total liabilities remained flat at ₱2.7 billion. As at the same date, SRL reported an interest expense to sales ratio of 16%, due to the unfavourable interest rate environment in the country although the net debt to average total assets moderated to 71%. With the recapitalisation of the Company in H1'2023, its IBL as a percentage of equity ratio improved to 57%. While we acknowledge Smart Residences Limited's higher leverage metrics in FYE 2022, we anticipate a gradual decrease in the near term due mainly to the additional earnings and cash flows to be generated from its debt-funded expanded operations. Agosto & Co. expects the aforementioned factors to consistently bolster Smart Residences' financial flexibility in the near term.

OUTLOOK

The Flexible Accommodation subset of the Nigerian Hospitality Industry continues to experience sustained growth primarily supported by the significant recovery of economic activities and resumption of tourism and business travels across the country. Industry growth has also been supported by the relatively low barriers to entry, which enables operators to adapt quickly to rapidly changing tastes and location preferences of consumers, although we believe that this could result in increased competition in the near term, translating to lower profit margins for current participants. Consequently, Agosto & Co. notes that the long-run survival of operators ultimately depends on implementing strategies to diversify revenue and easy adaptability to changes in demand.

Backed by the sustained demand for its flexible apartments, Smart Residences Limited is currently in the process of expanding its operations evidenced by initiatives to launch 'The Home Away' Apartments - a 70-unit complex that comprises both one-bedroom and two-bedroom apartments in November 2023. Similarly, Smart Residences Limited plans to leverage the demand for luxury short-let apartments and exploit the untapped markets in other commercial hubs in Nigeria particularly Kano and Lagos in the near term. In the same vein, Smart Residences Limited plans to diversify its revenue profile to include real estate and property management as well as the provision of related services to real estate operators. Agosto & Co. anticipates the growth trend in the Company's earnings base to continue as the aforementioned strategies are implemented and occupancy rates continue to rise. Nevertheless, we recognise that the rising energy prices on account of higher crude oil prices globally and the persistent inflationary pressures would translate to higher operating expenses and increased margin pressures. Nonetheless, we expect SRL's profitability indicators to remain good in the near term.

With the anticipated growth in net earnings following the introduction of The Destination and soon-to-be-completed The Home Away apartments, we expect the Company's cash flow position to remain good in the near term. Furthermore, backed by a combination of additional shareholder support and higher profitability levels bolstering its equity buffer, we expect the working capital position to remain adequate in FYE 2023. We expect the Company's higher leverage metrics to moderate in the near term on the back of the additional equity injection and accretion via increased earnings (as no dividend payment is envisaged by SRL in the near term).

Based on the aforementioned, we hereby attach a **stable** outlook to Smart Residences Limited.

FINANCIAL SUMMARY

STATEMENT OF COMPREHENSIVE INCOME	31-Dec-20		31-Dec-21		31-Dec-22		30-Jun-23 (Unaudited)	
	₦'million		₦'million		₦'million		₦'million	
REVENUE	119	100.0%	474	100%	1,618	100%	1,093	100%
GROSS PROFIT	105	88.2%	429	90.5%	1,270	78%	782	72%
OPERATING PROFIT	6	5.0%	174	36.7%	663	41%	428	39%
INTEREST EXPENSE	0	0	0	0%	(108)	-7%	(180)	-16%
PROFIT BEFORE TAXATION	6	0	146	31%	368	23%	114	10%
TAX (EXPENSE) BENEFIT	(1)	-1.0%	(44)	-9%	(94)	-6%	(52)	-5%
PROFIT AFTER TAXATION	5	4%	102	22%	274	17%	63	6%
DIVIDEND	0	0%	0	0%	0	0%	0	0%
PROFIT RETAINED FOR THE YEAR	5	4%	102	22%	274	17%	63	6%
OTHER APPROPRIATIONS/ ADJUSTMENTS	0		(11)		0		0	
PROFIT RETAINED B/FWD	0		5		96		370	
PROFIT RETAINED C/FWD	5		96		370		432	

STATEMENT OF FINANCIAL POSITION	31-Dec-20		31-Dec-21		31-Dec-22		30-Jun-23 (Unaudited)	
	₦'million		₦'million		₦'million		₦'million	
ASSETS								
CASH & EQUIVALENTS	1	0%	4	1%	681	19%	649	18%
TOTAL TRADING ASSETS	107	38%	5	1%	556	16%	623	17%
TOTAL LONG-TERM ASSETS	171	61%	706	99%	2,324	65%	2,435	66%
TOTAL ASSETS	280	100%	715	100%	3,561	100%	3,706	100%
<i>Growth</i>	0.0%		155.8%		398%		4%	
LIABILITIES & EQUITY								
TOTAL INTEREST-BEARING LIABILITIES	0	0%	0	0%	1,300	37%	1,192	5%
TOTAL NON-INTEREST-BEARING LIABILITIES	59	21%	228	32%	1,463	41%	1,555	19%
TOTAL LIABILITIES	59	21%	228	32%	2,763	78%	2,747	25%
SHAREHOLDERS' EQUITY	220	79%	487	68%	798	22%	960	75%
TOTAL LIABILITIES & EQUITY	280	100%	715	100%	3,561	100%	3,706	100%

CASH FLOW STATEMENT	31-Dec-20		31-Dec-21		31-Dec-22		30-Jun-23 (Unaudited)	
	₦'million		₦'million		₦'million		₦'million	
OPERATING ACTIVITIES								
POTENTIAL OPERATING CASH FLOW	39		333		1,756		405	
WORKING CAPITAL CHANGES:								
CASH FROM (USED BY) SPONTANEOUS FINANCING	59		34		51		23	
CASH FROM (USED BY) TRADING ASSETS	(107)		102		(551)		(66)	
CASH FROM (USED IN) OPERATING ACTIVITIES	(9)		469		1,255		362	
RETURNS TO PROVIDERS OF FINANCING (RTPOF)								
INTEREST PAID	0		0		(108)		(180)	
DIVIDEND PAID	-		-		-		-	

OPERATING CASH FLOW AFTER PAYMENTS (RTPOF)	(9)	469	1,147	182
CASH FROM (USED IN) INVESTING ACTIVITIES	(205)	(642)	(1,807)	(206)
CASH FROM (USED IN) FINANCING ACTIVITIES	216	175	1,337	(9)
CHANGE IN CASH INC/(DEC)	1	2	677	(32)
OPENING CASH & MARKETABLE SECURITIES	0	1	4	681
CLOSING CASH & MARKETABLE SECURITIES	1	4	681	649

KEY RATIOS	31-Dec-20	31-Dec-21	31-Dec-22	30-Jun-2023 (Unaudited)
PROFITABILITY				
SALES GROWTH	0%	297%	241%	35%
OPERATING PROFIT MARGIN	5%	37%	41%	39%
RETURN ON ASSETS (PRE-INTEREST PRE-TAX)	2%	20%	13%	16%
RETURN ON EQUITY (PRE-TAX)	3%	30%	46%	24%
CASH FLOW				
OCF AS % OF RETURNS TO PROVIDER OF FINANCING	0%	0%	1162%	201%
OCF AS % OF SALES	-7%	99%	78%	33%
WORKING CAPITAL				
WORKING CAPITAL NEED (DAYS)	0	0	93	152
OVERALL WORKING CAPITAL DEFICIENCY (DAYS)	0	0	0	0
LEVERAGE				
NET DEBT AS % OF AVERAGE TOTAL ASSETS	41%	45%	116%	71%
TOTAL LIABILITIES TO EQUITY	27%	47%	346%	286%
OTHER ADDITIONAL INFORMATION				
STAFF COSTS (₹ MILLION)	10	34	65	65
AVERAGE NUMBER OF STAFF	9	28	27	27
STAFF COSTS PER EMPLOYEE (₹ MILLION)	1	1	2	2
CAPITAL EXPENDITURE (₹ MILLION)	171	365	410	0
DEPRECIATION AND AMORTISATION (₹ MILLION)	34	154	296	169
EBITDA (₹ MILLION)	40	300	772	463
AUDITORS	Abdul-Azeez Ishaq & Co	Abdul-Azeez Ishaq & Co	Abdul-Azeez Ishaq & Co	Unaudited
OPINION	CLEAN	CLEAN	CLEAN	N/A

RATING DEFINITIONS

Aaa	A company with the best financial condition and strongest capacity to meet obligations as and when they fall due relative to all other issuers in the same country.
Aa	A company with very good financial condition and a strong capacity to meet its obligations as and when they fall due relative to all other issuers in the same country.
A	A company with good financial condition and a strong capacity to meet its obligations relative to all other issuers in the same country.
Bbb	A company with satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due relative to all other issuers in the same country.
Bb	A company with satisfactory financial condition but limited capacity to meet obligations as and when they fall due relative to all other issuers in the same country
B	A company with weak financial condition and weak capacity to meet obligations as and when they fall due relative to all other issuers in the same country.
C	A company with very weak financial condition and very weak capacity to meet obligations as and when they fall due are relative to all other issuers in the same country
D	In default.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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