EthiFinance Ratings

BBB-

ISSUER RATING

Long-term Rating

Outlook: Positive

First rating date: 06/09/2019
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## Contacts

**Associate Director**
Aitor Sanjuan Sanz
aitor.sanjuan@ethifinance.com

**Chief Rating Officer**
Guillermo Cruz Martínez
guillermo.cruz@ethifinance.com

# Rating Action and rationale

- EthiFinance Ratings affirms Grupo Pestana's "BBB-" rating, changing its outlook from Stable to Positive.
- Grupo Pestana presents a robust competitive positioning within an industry which is showing a consistent recovery dynamic. This characteristic, together with the group's historical ability to generate positive results and operating cash flow while preserving a strong financial structure, have enabled Grupo Pestana to report an outstanding recovery. A maintenance of the solid 3Q22 figures in the upcoming years would likely result in an upgrade of the rating.
- The hotel and leisure industry has medium ESG risk (heatmap score of between 2 and 2.9) given its impact on the environment.

# Issuer description

Grupo Pestana focuses its activity on the management of 79 hotels (8,696 rooms), 9 units of vacation club, 6 golf courses (3 in ownership), 1 casino gambling concession, 1 brewery company, and, also, tourist animation and tourist real estate developments, all of which are located in Portugal. They operate exclusively in the Portuguese market, but the majority of their clients are non-Portuguese. The company is the Portuguese subsidiary of Pestana International Holding (PIH) which operates 107 units of tourist lodging with over 12,500 rooms across 16 countries. Grupo Pestana's turnover in 2021 reached €262.2MM (+60.7% YoY) with an EBITDA of €79.6MM (30.3% EBITDA margin). NFD/EBITDA stood at 5.3x. As of the end of 3Q22, the company reported €299.8MM revenues and an EBITDA of €114.2MM (38.1% EBITDA margin). NFD/EBITDA LTM stood at 1.8x.

We highlight that the parent company's credit quality does not have an effect on Grupo Pestana's rating since PIH has similar figures and a slightly better positioning. Additionally, there is no asset from Grupo Pestana that is guaranteeing any loan to PIH.

**The company issued a €60MM senior unsecured bond in 2019 and another one of €29MM in 2021 which has the same rating (BBB-) as Grupo Pestana's corporate rating.**

*In assigning the rating, the financial projections provided by Grupo Pestana and PIH for the period 2022-2023 have been taken into account. The company considers this information to be internal and confidential and therefore it has not been reflected in the report.*

# Fundamentals

## Business Profile

### Industry Risk Assesment

- **Sector which is progressing soundly towards a full recovery.** The tourism and hospitality sectors were directly affected by COVID-19 crisis given their exposure to falling consumer demand, travel restrictions and the downward turn of the economy. This was reflected in a volume of international arrivals which sharply decreased in 2020. As of the end of the first quarter of 2021, the progress in vaccination and the reopening of the borders allowed the beginning of the recovery. Nevertheless, it was not until 2022 (in the summer season), when the hospitality metrics begin to show figures similar to those achieved in 2019. Apart from the international tourist arrivals recovery (from June to September 7,139 thousand tourist arrived to Portugal vs 7,281 in 2019), number of nights in tourist accommodation establishments exceeded the figures for 2019 between June and September (33,402 thousand nights in 2022 vs 32,667 in 2019 during this period). Although we take into account the existing macroeconomic uncertainties (high inflation, growing energy prices, interest rate hikes, etc.), we expect the sector to maintain this positive dynamic for the last quarter of the year and 2023.

- **The hotel and leisure industry has medium ESG risks (heatmap score of between 2 and 2.9) and therefore has a neutral rating effect.** This means that it is a sector whose adaptation to ESG trends is in process. ESG trends are structural and business opportunities that exist, but further adaptation is still needed to reach positive financial or societal benefits. Conversely, there are low expected dependencies or negative impacts from ESG factors on stakeholders.

## Company's Competitive Positioning

- **Reference competitive position as the leading hotel chain in Portugal with a more limited positioning internationally.** Grupo Pestana is strongly positioned in the Portuguese market as the leading hotel chain in terms of number of rooms. With 50 years of experience, the company shows a deep knowledge and a successful trajectory in the industry which is also reinforced by a well-known portfolio of brands. However, its brand awareness outside of the domestic market is weaker. It is worth highlighting that the company's growth potential within the domestic market is relatively limited due to its already leading position.
- **Adequately diversified business generation.** Hospitality has been the company's main source of business; however, this activity has been constrained by its lack of geographic diversification beyond Portugal and a hotel portfolio concentrated on the holiday resorts segment, lacking a significant presence in the city/business segment (17.1% over total rooms). The majority of the hotel pipeline being developed are city hotels in order to reduce its focus on resorts. Therefore, the company is significantly exposed to the cyclical nature of tourism albeit partly mitigated by its strong focus on the upscale segment and a well-diversified feeder market portfolio (68% of guest originated outside of Portugal). Nevertheless, it is worth highlighting that the group, as part of its diversification strategy in the last years, has increased the development of its real estate division which has gained relevance in terms of sales. The company has taken advantage of an industry which has presented a significant resilience, contributing to the mitigation of the crisis and allowing them to report a faster recovery.
- **Asset-heavy hotel business model which results in a high-quality asset portfolio.** The company's operating model is asset-heavy, limiting its pace of portfolio growth and exposing it to a higher demand risk relative to asset-light formulas. Rooms under management/franchised were only a 9.7% over the total which is partly a consequence of the peculiarities of the hotel sector in Portugal. However, this business model results in a valuable portfolio of fixed assets (estimated market value of €1.17Bn) and provides additional financial flexibility. We take a favorably view in that Grupo Pestana, although operating a business model intensive in capital, shows controlled debt levels.

## Governance

- **Family-owned group backed by a professionalized management team whose decision-making has led to a successful trajectory.** Grupo Pestana is controlled by its founder, Mr. Dionisio Fernandes Pestana, who has shown an outstanding track record in managing the business and a proven commitment with the group evidenced, amongst other things, by the constant reinvestment of the group's cash flows into the business. Furthermore, its parent company, PIH, adds geographic and operational diversity (city hotels) to Grupo Pestana's business profile. Grupo Pestana counts with a highly professionalized management team which has been instrumental in the positive performance of the company in the recent years.
- **The group does not present any controversies.** Our controversies assessment determines that there are no news or events which constitute a real issue that point to a weakness in Grupo Pestana's operations or organization, and which would need monitoring.

## Financial Profile

### Cash-flow and leverage

- **Profitable group which has shown an outstanding post-pandemic recovery.** Grupo Pestana's activity reported a relevant growth during 2021 and 2022 (sales of €262.2MM in 2021 and €299.8MM in 3Q22; +60.7% YoY and +69.5% YoY). This has been based on the group's solid competitive positioning and adequate reopening strategy within a recovering hotel industry, and a diversified business model, highlighting a real estate division which has performed positively during recent years. The favorable revenues evolution has been transferred to operating results which returned to high levels (EBITDA of €79.6MM in 2021 and €114.2MM in 3Q22). Margins stood above the main competitor's levels (EBITDA margin of 30.3% and 38.1% in 2021 and 3Q22, respectively) driven by the company's focus on optimizing its EBITDA per room ratio, a well-managed cost structure, and a real estate business which contributed favorably. This together with the controlled financial expenses resulted in a company which presents an outstanding profitability profile.
- **Favorable capacity to meet its financial obligations.** NFD/EBITDA LTM ratio stood at the end of the third quarter of 2022 at 1.8x (NFD/EBITDA ratio of 5.3x in 2021), improving significantly during recent years. Grupo Pestana has demonstrated a strong capacity to generate positive operating results once the macroeconomic situation recovered, a characteristic which enables them to appropriately meet their financial obligations. This assessment is additionally reinforced by an adequate interest coverage ratio (EBITDA/Interest of 8.7x in 3Q22).

### Solvency

- **Strong solvency levels reinforced by a highly valuable portfolio of assets.** Grupo Pestana operates a balanced financial structure characterized by an adequate financial autonomy (Equity/TFD ratio of 76.7% at the end of 3Q22) and a controlled indebtedness (TFD reached €451.6MM in 3Q22). Although operating a capital intense business model based on holding a large part of the assets where the business units are located (hotels, golf courses and land), which implies consequently higher debt levels, the group has been capable of maintaining a manageable financial structure. This is additionally reinforced by the group's ability to generate solid EBITDAs, its highly valuable asset portfolio (LTV of 26.6% at the end of 3Q22) which could be accessed for sale to help the company under a stress scenario, and a well-structured debt profile.

### Liquidity

- **Strong liquidity position which ensures the company's capacity to meet its financial and investment requirements in the short-term.** The company reports a favorable liquidity situation driven by its ample treasury position (€207.8MM in cash + €108MM in undrawn credit facilities in 3Q22), a demonstrated solid capacity to generate fund from its operations (FFO €115.3MM in 3Q22) and a comfortable debt maturity schedule (>60% of debt matures in 2025 and beyond). This is additionally reinforced by its favorable financial flexibility which is based on the company's adequate access to the debt market and a valuable portfolio of assets that could be accessed for sale under a hypothetical stress scenario.

# Main financial and extra financial figures

| Main financial figures. Thousands of €. | 2019 | 2020 | 2021 | 3Q22[1] | 21vs20 |
|---|---|---|---|---|---|
| Turnover | 349,093 | 163,105 | 262,187 | 299,844 | 60.7% |
| EBITDA[2] | 131,610 | 41,897 | 79,560 | 114,203 | 89.9% |
| EBITDA Margin | 37.7% | 25.7% | 30.3% | 38.1% | 4.7pp |
| EBT | 82,196 | -23,482 | 30,950 | 108,421 | 231.8% |
| Total Assets | 1,076,794 | 962,715 | 1,001,553 | 1,090,195 | 4.0% |
| Equity | 310,749 | 272,440 | 287,036 | 346,427 | 5.4% |
| Total Financial Debt | 503,508 | 471,607 | 492,551 | 451,580 | 4.4% |
| Net Financial Debt | 388,446 | 413,825 | 418,413 | 243,764 | 1.1% |
| Loan To Value[3][4] | 28.7% | 31.7% | 33.0% | 26.6% | 1.3pp |
| NFD/EBITDA | 3.0x | 9.9x | 5.3x | 1.8x[5] | -4.6x |
| Funds From Operations | 120,288 | 18,901 | 71,615 | 115,511 | 278.9% |
| FFO/NFD | 31.0% | 4.6% | 17.1% | 59.2%[5] | 12.5pp |
| EBITDA/Interest | 7.8x | 2.6x | 4.9x | 8.7x | 2.3x |

[1]Unaudited figures. [2]EBITDA Normalized, excluding capital gains from the sale of assets to holding company (PIH). [3]Secured debt of €122.5MM in 2019, €150MM in 2020 and €170MM in 2021. [4]GAV includes adjustments in 2020 and 2021 due to COVID-19. In 3Q22 it is considered a complete recovery (latest fixed assets valuation of €1.17Bn). [5]EBITDA and FFO LTM.

# Rating Sensivity

Factors that may (individually or collectively) impact the rating:

- **Positive factors (↑).** Maintenance of the growing business and high profitability levels. A financial structure which remained characterized by the robust solvency levels and favourable coverage ratios (NFD/EBITDA and EBITDA/Interest ratio).
- **Negative factors (↓).** Lower profitability levels. Higher NFD/EBITDA ratio. Worsening of the group ability to generate cash in its operations.

# Regulatory information

## Sources of information

The credit rating assigned in this report has been requested by the rated entity, which has also taken part in the process. It is based on private information as well as public information. The main sources of information are:

- Annual Audit Reports.
- Corporate Website.
- Information published in the Official Bulletins.
- Rating book provided by the Company.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

## Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the Corporate Rating Methodology and Outlook Methodology that can be consulted on https://www.ethifinance.com/en/ratings/methodologies and according to the Long-term Corporate Rating scale available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

C/ Velázquez nº18, 3º derecha, 28001 - Madrid - España.