BBB-

ISSUER RATING

Long-term Rating

Outlook: Negative

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Executive Summary

Detailed below is the Executive Summary of the **public rating** assigned by Axesor Rating to Grupo Pestana, SGPS, S.A and its subsidiaries.

Grupo Pestana focuses its activity on the management of 73 hotels, 9 units of vacation club, 6 golf courses, 4 real estate ventures, 1 casino gambling concession and 1 brewery company. They operate exclusively in the Portuguese market. The company is the Portuguese subsidiary of Pestana International Holding (PIH) which operates 100 hotel units and 6 tourist ventures, with over 11,500 rooms across 15 countries in Europe, Africa, North and South America. Grupo Pestana's turnover in 2019 was €349.1MM (-4.3% YoY) with an EBITDA of €131.6MM (37.7% EBITDA Margin). NFD/EBITDA stood at year end in 3 times. 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 significant asset from Grupo Pestana that is guaranteeing any loan to PIH.

The impact of the COVID-19 pandemic on the tourist industry has begun to show its negative effects on Grupo Pestana's main figures which show a very significant impariment during the first three quarters of 2020. In this period, the company's top line stood at €127.2MM (-54.7% YoY) and EBITDA decreased by 72.9% and reached €29.7MM (23.4% EBITDA Margin). EBT was negative in €17.7MM (Net Income -€11.8MM). Although the deterioration is obvious, we positively value the company's ability to reduce the impact of the crisis in comparison with other hotel chains which registered much higher income losses.

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

Fundamentals

Business profile

- **High exposure to the tourist industry, severely impacted by COVID-19 crisis.**

  The tourism and hospitality sectors are directly affected by the crisis given their exposure to falling consumer demand (compounded by a fear of travel), travel restrictions and the downward turn of the economy (high correlation with the economy). As a result, and as seen in 3Q20 figures, a significant decline in the activity is expected for the full year 2020. Additionally, with renewed upticks in COVID-19 infections in Portugal (re-openings have paused, and targeted shutdowns are being reinstated), the objective to recover pre-pandemic activity levels, has become more uncertain. Based on this, we value the sector outlook as unfavorable.

- **Reference competitive position as the leading hotel chain in Portugal with a more limited positioning internationally.**

  Strongly positioned in the Portuguese market as the leading hotel chain in terms of number of rooms. With more than 45 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, the company's growth potential within the domestic market is relatively limited due to its already leading position. On the other hand, its brand awareness outside of the domestic market is weaker.

- **Asset-heavy 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 an 11% over the total and 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. It is valued favorably that Grupo Pestana, although operating a business model intensive in capital, shows controlled debt levels.

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- **Business concentrated in the Portuguese market and the resort and leisure segment.**

  Grupo Pestana's business profile is constrained by its lack of geographic diversification beyond Portugal and a hotel portfolio which is concentrated in the holiday resorts segment, lacking a significant presence in the city/business segment (17% over total rooms). The majority of the hotel pipeline being developed are city hotels in order to reduce its focus on resorts. The company is significantly exposed to the cyclical nature of tourism albeit mitigated by its strong focus on the upscale segment, which is valued positively, and its diversified feeder markets (34% of guests originated in Portugal with the remaining 66% coming from the UK, Germany, the US, etc.).

- **Family owned group backed by a professionalized management team whose decision-making has lead to 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 Pestana's business profile. Finally, Grupo Pestana counts with a highly professionalized management team which has been instrumental in the positive performance of the company in the recent years.

Financial profile

- **Solid activity and high profitability margins which are being conditioned by the healthcare and economic crisis.**

  The company, which has been characterized by its recurring business, due to its strong positioning in Portugal, and especially high EBITDAs and net earnings (higher profitability levels than the main players in the industry based on its long-term vision, prudent investment policy and capacity to manage its cost structure), has seen its business severely impacted by the current coronavirus outbreak. Therefore, a significant drop in sales is expected for 2020 (-€153.4MM 3Q20vs3Q19) which will result in negative EBIT and EBT. However, we highlight that Grupo Pestana's measures and its flexible cost structure are allowing the company to control its losses, which are being much lower than the main European hotel groups.

- **Stable financial structure with adequate financial autonomy and controlled indebtedness which is reinforced by the solvency provided by the valuable portfolio of assets.**

  Financial structure with adequate equity levels (Equity/TFD of 61.7%) and a controlled indebtedness (TFD of €503.5M in 2019 and €468.6MM at the end of 3Q20), especially taking into account its business strategy of holding on its Balance Sheet a large part of the assets (hotels, golf courses and land) where the business units are installed. Consequently, and although an equity deterioration is expected driven by the estimated losses (Net Income of -€18MM in 2020E), due to the COVID-19 crisis effects on the company, the high value of its hotel portfolio (€1.17Bn) is considered to reinforce favorably Grupo Pestana financial structure providing additional solvency.

- **Strong liquidity which allows the company to show an adequate capacity to attend its financial obligations despite the significant upturn expected in the NFD/EBITDA ratio in 2020.**

  NFD/EBITDA ratio which stood at 3x in 2019 is projected to suffer a significant increase (NFD/EBITDA in 2020E of 11.7x). Nevertheless, Grupo Pestana displays enough capacity to meet adequately its financial requirements based on its positive cash position (€66.3MM in cash + €62MM in undrawn credit facilities in 3Q20) a debt maturity schedule that is long-term in nature (at the end of 3Q20, 80.6% of its debt matures in 2023 onwards) and a valuable portfolio of assets which could be accessed for sale to help the company under a stress scenario.

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Main financial figures

Main financial figures. Thousands of €.

	2017[(1)]	2018[(1)]	2019	2020E	19vs18
Turnover	342,171	364,809	349,093	162,100	-4.3%
EBITDA[(2)]	117,774	137,560	131,610	35,100	-4.3%
EBITDA Margin	34.4%	37.7%	37.7%	21.7%	0.0pp
EBT	101,045	79,963	82,196	-23,200	2.8%
Total Assets	951,888	974,889	1,076,794	-	10.5%
Equity	269,840	247,461	310,749	-	25.6%
Total Financial Debt	424,262	436,627	503,508	461,000	15.3%
Net Financial Debt	367,982	396,911	388,446	411,200	-2.1%
Equity/TFD	63.6%	56.7%	61.7%	-	5.0pp
NFD/EBITDA	3.1x	2.9x	3.0x	11.7x	0.1x
Loan To Value[(3)]	-	34.1%	33.1%	-	-1.1pp
FFO/NFD	28.6%	31.2%	29.1%	7.9%	-2.1pp
EBITDA/Interest	7.9x	7.4x	7.8x	2.3x	0.4x

[(1)]Restated accounts including IFRS16.[(2)]EBITDA Normalized, excluding capital gains from the sale of assets to holding company (PIH). [(3)]Secured debt of €132MM in 2018 and €122.5MM in 2019

Rating and Outlook

Axesor Rating is downgrading Grupo Pestana's rating to BBB- (previously BBB/Negative outlook, 2020/04/08) based on the weakening of the credit profile of the company driven by the significant impact of the COVID-19 outbreak on the hospitality industry and the group business.

The outlook for this rating has been placed on negative based on the current economic crisis, which is significantly affecting the tourist sector given its exposure to travel restrictions and sensitivity to consumer demand. Therefore, a significant fall in business is expected both for 2020 and 2021.

The company will be kept under constant review in the face of the current uncertain and complex economic context.

Rating sensitivities

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

- **Positive factors (↑).** Recovery of the industry. Reduction in the NFD/EBITDA ratio. Improvement of the financial autonomy levels (Equity/TFD). Operating margins recovery.
- **Negative factors (↓).** Higher than expected economic slowdown and of a more prolonged nature that would have a significant negative effect on activity. Maintenance of the negative final results that would continually erode levels of financial autonomy. Significant and sustained increase in the NFD/EBITDA ratio. Deterioration of the capacity to generate operating cash flow.

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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:

1. Annual Audit Reports.
2. Corporate Website.
3. Information published in the Official Bulletins.
4. Rating book provided by the Company.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, Axesor Rating 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 www.axesor-rating.com/en-US/about-axesor/methodology and according to the Long-term Corporate Rating scale available at www.axesor-rating.com/en-US/about-axesor/rating-scale.
- Axesor 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 axesor 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.

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