BBB

ISSUER RATING

Long-term Rating

Outlook: Stable

First rating date: 06/09/2019

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Content

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 70 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 93 hotel units and 6 tourist ventures, with over 11,000 rooms across 15 countries in Europe, Africa, North and South America.

Grupo Pestana's turnover in 2018 was €364.9MM (+6.7% YoY) with an EBITDA of €123MM (33.7% EBITDA margin). NFD/EBITDA stood at year end in 2.9 times (including IFRS16 adjustment), NFD/EBITDA unadjusted of 2.1x).

The company is planning a €50MM senior unsecured bond issuance which will have the same rating (BBB) as Grupo Pestana´s corporate rating.

Fundamentals

Business profile

- **Strong 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 hotels and 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 in Portugal. These factors remain a differential factor in the sector. However, its brand awareness outside of the domestic market is weaker. The weight of direct sales over total turnover is 27%, being this sales channel the most profitable.

- **Asset-heavy business model which result 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 €1.16Bn) and provides additional financial flexibility.

- **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). Its feeder markets, however, provide diversification benefits since only 22% of guests originated in Portugal with the remaining 78% coming from the UK, Germany, the US, etc. The company is exposed to the cyclical nature of tourism albeit mitigated by its strong focus in the upscale segment, which is valued positively. The majority of the hotel pipeline being developed are city hotels in order to reduce its focus on resorts. The company's growth potential within the domestic market is relatively limited due to its already leading position.

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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. All the 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/about-axesor/methodology and according to the Long-term Corporate Rating scale available at www.axesor-rating.com/en/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.

- **Pestana operates in a highly competitive sector which is dominated by a few well-know hotel brands and which is exposed to potential economical and political disruptions.**

  Globally, the hotel sector is mainly composed of more than 500 large hotel groups, being a sector with a high proportion of smaller establishments though dominated by a few well-known hotel brands with large geographic footprints. The industry which is highly competitive is closely correlated to the economic cycle and more specifically in Europe, is going to face diverse factors which could negatively impact the business (Brexit, recovery of destinations in the southern Mediterranean such as Turkey and Egypt, EU economic slowdown, etc.). The company's economic figures demonstrates a strong resilience to down-turns based on its flexible cost structure, a characteristic that is valued positively.

- **Family owned group backed by a professionalized management team whose decision-making has lead 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 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 reinforced by profitability margins which are higher than the industry average based on the company's effective cost control and accompanied by a strict investment policy.**

  The company's top line performance has been very positive during recent years (CAGR14-18; +13.2%) driven by their strong positioning in Portugal which have enabled them to take advantage of the positive industry trend. Their long-term vision and prudent investment policy, which result in low investment amounts per hotel room, together with their ability to successfully manage their cost structure provides Grupo Pestana with high operating margins (EBITDA margin of 33.7%) and strong net profits.

- **Stable financial structure reinforced by a NFD/EBITDA which remained controlled.**

  Grupo Pestana displays a financial structure with adequate equity levels and a controlled indebtedness. These debt levels are considered suitable in relation to its operating results (NFD/EBITDA with IFRS16 ratio of 2.9x) which are also reinforced by the GAV of its hotel portfolio (€1.16Bn). Grupo Pestana's NFD/EBITDA is lower than its peers and the company shows a more than adequate capacity to meet its financial requirements which are mainly long-term in nature. They are planning a debt issuance of €50MM which will help to extend their maturity schedule.

- **Favourable liquidity situation which enables the company to adequately meet its business requirements.**

  The company has a reasonable liquidity level favoured by a solid FFO, a positive treasury position (cash + available credit facilities) and adequate financial flexibility (access to the debt markets). This allows them to continue funding their capex needs, the payment commitments associated to its debt (long-term in nature) and the required dividend distributions. On a forward-looking basis, in 2020, Grupo Pestana's sources of funds will cover its commitments by 4x.

Main financial figures

Main financial figures. Thousands of €	2016	2017	2018	18vs17
Turnover	302,172	342,171	364,950	6.7%
EBITDA[1]	100,974	145,511	123,000	-15.5%
EBITDA Margin	33.4%	42.5%	33.7%	-8.8pp
Pre-tax Income	47,817	101,045	82,278	-18.6%
EBITDA normalized[2]	97,439	117,774	121,385	3.07%
EBITDA Margin normalized[2]	32.25%	34.42%	33.26%	-1.2pp
Equity/TFD	72.7%	90.6%	89.8%	-0.8pp
Equity/TFD with IFRS16	57.3%	63.6%	61.2%	-2.4pp
NFD/EBITDA	3.0x	1.7x	2.1x	0.4x
NFD/EBITDA with IFRS16	3.6x	2.3x	2.9x	0.6x
Total Assets	1,024,350	951,888	858,624	-9.8%
Funds From Operations[1]	88,219	105,315	123,850	17.6%
FFO[1]/NFD	25.3%	36.8%	48.1%	11.3pp
FFO[1]/NFD with IFRS16	19.9%	26.3%	33.1%	6.8pp
EBITDA/Interest	4.8x	9.7x	11.3x	1.6x

[1]Calculated by the company.

[2]Excluding capital gains from the sale of assets to holding company (PIH).

Outlook

The outlook for this rating is **stable** based on the company's adequate business fundamentals and solid financial situation. The outlook considers that the company will continue to successfully manage its business and will maintain an adequate financial structure. We do not expect changes in the rating in the short-term.

1. Company profile

1.1. Business and scope of activity

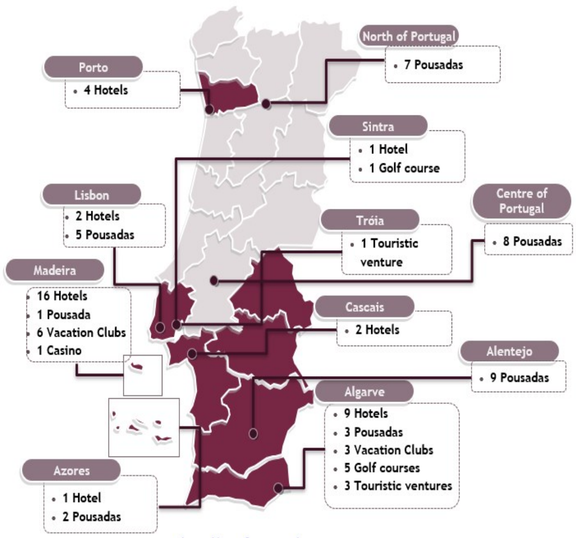
Pestana' organization structure

Grupo Pestana (Grupo Pestana, SGPS, S.A. and its subsidiaries) is a Portuguese company which focuses its activity on the tourist sector. The company is the Portuguese subsidiary of Pestana International Holding (PIH), the largest Portuguese group in the hospitality business (amongst the top-25 hotel groups in Europe and in the top-75 worldwide). PIH operates 93 hotel units and 6 tourist ventures, with over 11,000 rooms across 15 countries in Europe, Africa, North and South America. It was founded in 1972 and maintains a family-owned structure with Mr. Dionisio Fernandes Pestana (founding family) holding a 100% stake.

The company operates exclusively in Portugal and has a strong track-record, which provides them with a deep knowledge and proven experience in the industry. With more than 45 years of expertise, the company is currently positioned as the largest hotel chain in the Portuguese hospitality business in terms of number of units and rooms.

Grupo Pestana manages 70 hotels (35 of them Pousadas de Portugal) under its brands Pestana Hotels and Resorts, Pestana Pousadas de Portugal, Pestana Collection and Pestana CR7 "Lifestyle hotels". Additionally, they operate 9 vacation club units (all owned), 6 golf courses (5 in ownership), 4 real estate ventures, 1 casino gambling concession and 1 brewery company.

Grupo Pestana SGPS footprint.



At an operational level, the company develops its activities in the following five business lines:

- **Hospitality.** Comprises the management of 35 hotels across Portugal and 35 Pousadas of Portugal with a 20-year running concession awarded in 2003 and renewable for an other 5-year period.

- **Real Estate.** This area includes the construction and sale of villas and apartments for touristic use near Pestana's golf courses or hotels. This business line also includes additional services such as maintenance, gardening, housekeeping and rentals.

- **Vacation Club.** They manage 9 resorts located along the Algarve (3) and Madeira (6) regions. Through this business line, the company establishes long-term relationships with its customers, rewarding members´ loyalty with privileges, enabling club members to travel along the Group's hotels.

- **Brewery.** Grupo Pestana integrates Empresa de Cervejas da Madeira (ECM) in its portfolio since 1994. ECM is one of Madeira's most prestigious companies producing beer, soft drinks, juices, water and wines.

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- Others. This area includes 5 golf courses in the Algarve and 1 in Sintra, the management of Madeira's casino and the International Business Centre of Madeira (this latest a joint venture between Pestana Group and Madeira's regional government).

2. Qualitative analysis

2.1. Competitive positioning

"Leading positioning in the domestic market with a more limited competitive positioning internationally."

Portugal: Ranking by size.(1)

Rank	Chain Groups	Hotels	Rooms
1	Grupo Pestana SGPS(2)	70	6,293
2	Vila Gale Group	23	4,334
3	Accor Hotels	33	3,440
4	Marriott International	20	2,914
5	Hoti Hotéis	16	2,469
6	SANA Hotels	14	2,218
7	Tivoli Hotel & Resorts	10	1,997
8	IHG	12	1,962
9	VIP Hotels	9	1,724
10	Porto Bay Hotels & Resorts	10	1,521

(1)2018 data. (2)Grupo Pestana SGPS portfolio as of 2019/08. Source: Horwath HTL, European Chains & Hotels report 2019

Grupo Pestana is a reference in the hotel industry in Portugal, showing a more limited competitive positioning internationally (ranks 25th in Europe at PIH level). The company shows a leading position in the Portuguese market, in terms of number of hotels and rooms. This favorable positioning is the result of more than 45 years of experience in the sector, which provides them with a deep knowledge of the industry.

Throughout its trajectory, Grupo Pestana has grown organically as well as through M&A transactions of hotel chains, which has allowed the company to experience high growth rates. The company currently operates 70 hotels (Resorts and cities) with a total of 6,293 rooms under ownership, management, lease or franchise schemes.

The company operates its hotels under four brands: Pestana Hotels and Resorts, Pestana Pousadas de Portugal, Pestana Collection and Pestana CR7 "Lifestyle hotels". These are grouped into Luxury and Upscale segments, allowing them to adapt their offer to the requirements of each of their targets, offering a wide range of experiences for their guests.

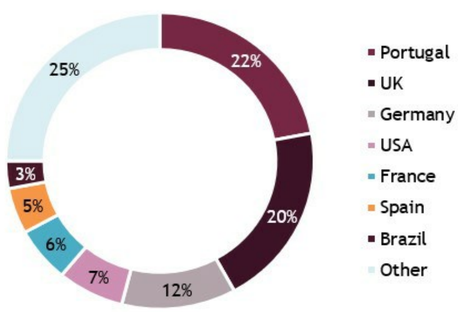
Within its brand portfolio we highlight the Pousadas de Portugal business which consist of a concession contract for the management of the Pousadas' network for a period of 15 years. These are national monuments which were granted by the Portuguese state for an unlimited period of time to Enatur, a state company (51% held by the Portuguese state with the remaining 49% acquired by Pestana Hotel Group in 2003). Although the contract was granted through a public tender to Pestana Hotel Group in 2003, it is expected that the concession will be extended until 2033 due to the complementary refurbishments and building expansions carried out by Pestana.

We additionally highlight the joint venture agreement that the group signed on December 2015 with Cristiano Ronaldo with the aim of promoting, developing and managing several hotel units. Accordingly, Pestana CR7 Lisbon and Pestana CR7 Madeira were incorporated to their portfolio, both 50%-owned by Grupo Pestana. We value favourably this partnership with Cristiano Ronaldo, one of the most influential soccer stars worldwide, which reinforces the company's brand positioning in Portugal and internationally. These two hotels will be joined by locations in Marrakech, Madrid, New York, Manchester and Paris. All of them at PIH level.

From Axesor´s point of view, brand recognition is positive within the domestic market, with a more limited brand awareness outside of Portugal. This is reflected in the low proportion of franchised hotels at the PIH level which only represented 10% of the total rooms, far from the leading companies with strong brand awareness with attract franchisees (franchised rooms accounted for the 55.4% and the 69% of total in Marriot and IHG, respectively).

"Business profile concentrated in the Portuguese market and the resort and leisure segment."

Main feeder markets. % of revenues.



The company concentrates its activity in the Portuguese market which constrains its business profile. This lack of international diversification results in a higher dependence on the cyclical nature of the tourist sector in Portugal which will have to face diverse challenges that could negatively impact the business: Brexit, recovery of competing destinations in the southern Mediterranean (Turkey, Tunisia, Egypt, etc.) geopolitical tensions, EU economic slowdown, etc. However, this dependence is mitigated by its feeder markets diversification with only 22% of guests originated in Portugal with the remaining 78% coming from the UK, Germany, the US, etc. Our main concern in this regard is the significance of the British market which represented 20% of total sales.

The uncertainty created by the possibility of a non-deal Brexit could condition significantly tourist flows from the United Kingdom, impacting Grupo Pestana's business. The company has been progressively reducing its dependence on British clients which is positively valued (in 2016 UK clients represented 26% of total sales).

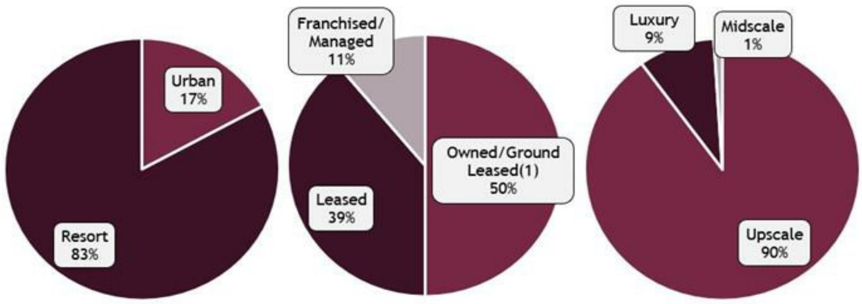
Within the domestic market, their hotel network is adequately diversified across the country, being primarily located in the key tourist areas of Portugal (Lisbon, Porto, Algarve and Madeira). In terms of rooms, Madeira is the main market representing 38.1%of total rooms. We positively highlight that Madeira presents a much lower seasonality than the other resort destinations in Portugal which facilitates the management of Pestana´s hotel business. Madeira is followed by Algarve which accounted for 30.8% of total rooms and Lisbon with 12.5%. This diversification is directly related with the company's business profile, primarily focused on the leisure and resort segment (83% of rooms). We positively value that a significant portion of the Pestana resort hotels have a unique location, with beach-front atlantic sea views in places where today it is no longer possible to build. The company expects to reduce its dependency on resorts with the majority of its hotel pipeline falling under the category of city hotels.

Rooms by location. Units.

	Rooms	% of total
Madeira	2,596	38.1%
Lisbon	850	12.5%
Oporto	196	2.9%
Algarve	2,096	30.8%
North Portugal	239	3.5%
Center Portugal	348	5.1%
Alentejo	322	4.7%
Azores	163	2.4%
Total	**6,810**[(1)]	

[(1)]Taking into account 4 residences. Data as of June 2019.

Rooms diversification as of 2019. % of total.



[(1)]Those classified as "ground lease" are usually long-term leases (more than 15 years) either of land or old buildings that are leased but converted to hotels (Grupo Pestana SGPS pays the conversion investment).

Within its core business, Grupo Pestana manages its hotels under different operating systems: ownership, lease, management and franchise. The company focuses on an asset-heavy strategy with 50% of total rooms under ownership. This business profile limits its pace of portfolio growth and exposes it to a higher demand risk relative to asset-light formulas. On the other hand, this business model results in a valuable portfolio of fixed assets (estimated market value of €1.16Bn) and provides them with additional financial flexibility. Leased hotels account for 39% of total rooms while franchised hotels only represent 11%.

"Asset-heavy business model which result in a high-quality asset portfolio."

At an operating level, the company develops its activities in five business lines, although the hotel segment is clearly its core business (55.8% of revenues in 2018). The remainder of their sales comes from residential real estate activities (17.2% of sales) as well as operating its Vacation club (8.2%), which completes the company's holiday offer, the brewery business (7.4%) and "others" business lines (11.3%) (golf courses and others).

Business diversification. Thousands of €.

	2017		2018		Evolution
	Amount	%	Amount	%	18vs17
Hospitality	221,895	64.8%	203,587	55.8%	-8.3%
Real Estate	26,400	7.7%	62,911	17.2%	138.3%
Vacation club	27,700	8.1%	30,027	8.2%	8.4%
Brewery	28,040	8.2%	27,164	7.4%	-3.1%
Others	38,135	11.1%	41,262	11.3%	8.2%
Total	**342,171**		**364,95**		**6.7%**

(1) At the end of 2017 Grupo Pestana SGPS sold to PIH its participation in the European and USA hotels – this resulted in a reduction of sales from 2017 to 2018 of EUR 27.664.

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From a sectorial perspective, the hotel industry, in which the company operates, has been characterized by a sustained growth in recent years, supported by a recurrent and growing tourist demand that has mitigated the highly competitive environment of the industry. Currently, there are more than 500 major hotel groups worldwide, being a sector that is dominated by a few, well-known hotel brands with large geographic footprints as well as a high proportion of smaller establishments.

“A highly competitive sector which is dominated by a few well-known hotel brands and which could present potential economical and political uncertainties.”

The tourist sector maintains a high correlation with the economic cycle, contributing to the socio-economic development of a growing number of countries, as a result of the progressive diversification of the sector. In addition, the high growth of tourism in relation to the economic growth of the past years, qualifies the industry as a very dynamic sector.

The tourist sector has maintained a positive performance in 2018 posting a sustained and significant growth worldwide (arrivals in millions increased by 6% 18vs17). As in recent years, the trend was particularly solid in destinations in Asia, while countries such as Tunisia, Turkey and Egypt are today showing clear signs of recovery, after years of being affected by terrorist activity and security threats. Europe, as a whole, has also remained solid in terms of performance, with a slow but stable growth (716 millions of arrivals in 2018).

In Portugal, the tourist sector confirms this trend towards a progressive stabilisation, which ended 2018 with a growth of 9.6%, a level lower than the previous years (+19.5% 17vs16; +10.7% 16vs15). The economic activity generated by tourism (revenues) in Portugal has proven to be notably resilient, representing 8.2% of the Portugal’s GDP.

Although we expect the activity level to be maintained in the upcoming years based on Portugal’s macroeconomic situation, which will continue its positive trend (expected GDP and CPI growths and an unemployment rate which will continue falling) and the positive sector fundamentals (social and political stability, high degree of tourism promotion by Government, attractive weather, well-invested airport network, etc.), this activity could be affected by potential economical and political uncertainties.

The industry, specifically in Europe, is going to face diverse factors which could negatively impact the business (Brexit, recovery of destinations in the Southern Mediterranean such as Turkey Tunisia and Egypt, geopolitical tensions, EU economic slowdown, etc.). These factors could even constrain activity in Portugal to a greater extent than other European destinations due to its characteristics (the UK as their main feeder market and the Southern Mediterranean destinations as direct competitors of Maderia and Algarve).

Grupo Pestana’s competitors include prestigious hotel groups that hold leading positions in the sector such as Meliá, Barceló, Accor and Marriott. The positioning achieved by the company is larger in terms of RevPAR than their competitors (except Marriott) which is valued positively. On the other hand, occupancy rates remains in line with these players.

Both the company and PIH show higher levels of profitability with respect to their peers driven by their strict investment policy which result in higher sales per room ratio. Additionally, the real state activity also contributes to achieve higher margins than its competitors.

Grupo Pestana exhibits better leverage levels relative to the main players in the sector, with a NFD/EBITDA ratio (adjusted for IFRS16) below its peers impact.

In terms of scale, although Grupo Pestana is the main hospitality company in Portugal (its most direct competitor is Vila Galé Hoteis with approximately half of the rooms), they remain far from the leading hotel chains worldwide such as Meliá, Accor and Marriot. This is reflected in the number of hotels/rooms of its portfolio, limiting the company's competitive positioning and brand recognition outside Portugal.

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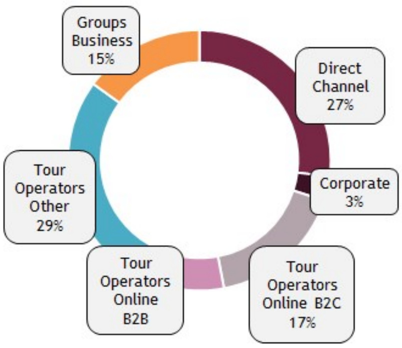
Peers comparison. €MM.

	Grupo Pestana	Pestana International Hotels	Meliá Hotels	Barceló	Accor Hotels	Marriot International[1]
Turnover	365	434	1,831	2,559	3,610	18,050
EBITDA	123	151	327	348	712	3,020
EBITDA Margin	33.7%	34.7%	17.9%	13.6%	19.7%	16.7%
Pre-tax Income	82	96	185	244	162	2,039
Equity/TFD with IFRS16	61.2%	70.3%	62.0%	234.1%	128.0%	19.5%
NFD/EBITDA with IFRS16	2.9x	3.1x	3.9x	3.2x	3.1x	3.2x
Total Assets	859	1,177	3,475	2,879	12,917	20,605
EBITDA/Interest	11.3x	8.9x	10.3x	21.7x	10.6x	10.2x
Nº of hotels	70	93	391	250	4,780	6,906
Nº of rooms	6,923	11,000	98,518	55,017	703,806	1,317,368
RevPar (€)	70.1	-	69.6	57.2	62.0	102.0
Occupation	69%	-	67%	74%	69%	73%

[1]Exchange rate: 1EUR=1.15USD.

Revenues by sales channel. % of total.



Although there is no significant customer concentration risk since its main client only represented 3.1% of total sales (top-10 clients represented 13.5% of revenues), tour-operators play an important role, accounting for 55% of total sales in 2018 and providing a substantial part of its clientele. Since tour-operators have strong bargaining power, Pestana must manage carefully this sales channel in order to defend its margins. The direct sales channel which is attractive because of its higher margins, accounted at year end for 27% of total sales. However, Pestana´s focus on the resort segment, which is highly dependent on tour operators is partly to blame for this unbalanced sales channel break-down.

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2.2. Management

Ownership structure and management team

"Family ownership structure which have shown a strong commitment with the business and a professionalized management team which has empowered the adequate performance in the recent years."

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.

Mr. Pestana, owner and Chairman, has been involved in the company's business since 1976, providing him with a long track-record within the company and a strong expertise in the sector. This ownership structure endows Grupo Pestana with the necessary stability to implement its long-term strategic objectives.

However, it must be noted that the ownership structure limits the amount of financial backing that the Pestana family can lend to its company at any given time though capital needs could be partially met through partnerships with third-party investment groups.

The Board of Directors is currently composed of four members, two of which are involved in the management. The Board is characterized by their expertise in the industry. The more than 45 years trajectory since their foundation and impressive track-record to date, evidence a decision-making process that is more than adequate. However, we note a concentration in the BoD, primarily made-up of the owner and members of the Executive Committee with only one independent member. The strong implication and commitment with the business mitigate this risk.

Composition of the Board of Directors.

Name	Position
Dionísio Fernandes Pestana	President of the BoD & Chairman
Hermanus Roelof Willem Troskie	Vice-President of the BoD. Independent member
José Alexandre Lebre Theotónio	Member of the BoD & CEO
José de Melo Breyner Roquete	Member of the BoD & CDO
Pedro Fino	Member of the BoD & CFO

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. Top management is well qualified and has demonstrated an in-depth insight and ability to successfully manage the group.

The company's annual accounts are audited by KPMG & Associados, offering a favorable opinion with respect to the 2018 financial accounts.

Management quality and strategy

"Growth strategy focused on maintaining the leading positioning in Portugal."

In the last years, Grupo Pestana has had a solid performance both on a financial and qualitative basis. The company's main financial figures have performed positively during recent years which is reflected in a growing turnover, solid profitability levels and a stable financial structure, enabling the company to show an adequate capacity to meet its business requirements.

Grupo Pestana will continue to focus its strategy on a long-term investment policy, with a cautious expansion policy that focuses on low investments per hotel room. This has enabled them to grow more profitably than its peers during the last years. The profile of targeted properties will be oriented to existing hotels, land plots or buildings to be converted located in the city center or in attractive tourism areas from 80 to 200 rooms. The company expects to maintain a business strategy focused on the upscale segment and also on buildings of historical value.

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Grupo Pestana´s dominating position in the Portuguese market limits its growth prospects within the country. Thus, future growth opportunities will primarily arise from its international expansion. The group (at PIH level) expects to open 8 new hotels in the upcoming three years which are going to be located in New York, Uruguay, Spain, France, the UK and Morocco.

Nationally, Grupo Pestana´s aim is to maintain its reference position as the main hotel chain in the domestic market. Their current pipeline consists of 3 hotels and 2 Pousadas which will be opening during 2020 with locations in Algarve, Oporto(2) and Lisbon(2). Axesor Rating takes a positive view of this expansion since it reinforces its positioning in city hotels and adds 1,162 new rooms.

The focus on corporate social responsibility is part of Grupo Pestana's business strategy and practice. The company internally implements the Pestana Planet Guest Sustainability Programme which is an all-encompassing concept that conveys the Pestana Group's position as an organisation and a group of people who respect and value the environment, society and corporate ethics. Additionally, as a part of their commitment to sustainability, Grupo Pestana has decided to issue an inaugural green bond. Axesor Rating takes a positive view of the company's commitment with Environmental, Social and Governance (ESG) criteria.

Financially, the company's future strategic plan will continue to be based on a prudent financial policy as a result of the maintenance of a controlled NFD/EBITDA ratio.

3. Quantitative analysis

To better understand the analysis, it is necessary to highlight the recent corporate reorganization executed within Grupo Pestana SGPS. During 2017, the Company sold its international business in Europe and the USA (Hotéis do Atlântico – Sociedade Imobiliária and Gestão, S.A.) to its parent company Pestana International Holding S.A. It also sold investments in the companies that provide centralized services to several companies of the Pestana Hotel Group, namely in the context of shared management support services, travel agency services and security (Pestana Management – Serviços de Gestão, S.A., Intervisa, Lda. and Pestana Segurança, Lda.).

The company' main financial figures evidence the positive performance over the recent years with significant growth in turnover and positive EBITDA levels. Their financial structure remains controlled with an adequate level of financial autonomy and a manageable leverage position which is also reinforced by the company's positive liquidity situation.

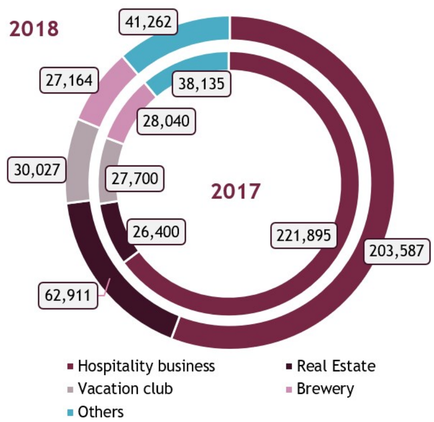
"Solid evolution of profitability and results favoured by an optimized cost structure and an excellent management of expenses."

Profitability. Thousands of €.

	2016	2017	2018
Turnover	302,172	342,171	364,950
Gross Mg	87.3%	85.9%	82.2%
EBITDAR[1]	114,955	160,084	132,892
EBITDAR Mg	38.0%	46.8%	36.4%
EBITDA[1]	100,974	145,511	123,000
EBITDA Mg	33.4%	42.5%	33.7%
EBITDA [2]	97,439	117,774	121,385
EBITDA Mg (2)	32.25%	34.42%	33.26%
EBIT	65,262	115,268	92,771
EBIT Mg	21.6%	33.7%	25.4%
Pre-tax income	47,817	101,045	82,278

[1] Calculated the company.
[2] EBITDA Normalized calculated excluding capital gains from the sale of assets to holding company (PIH).

Business diversification. Thousands of €.



3.1. Results and profitability

Grupo Pestana has shown a sustained growth in sales during the last years which is reflected in a significantly positive CAGR14-18 of 13.2%. In 2018, the company's top line stood at €364.9MM, increasing by 6.7% vs 2018. Excluding the effect related to the spin-off of their hotel business in Europe and the US, annual growth was around 16% thanks to the extraordinary growth of its real-estate business.

The positive evolution during the year was mainly driven by the excellent development of the real estate business line which grew by €36.5MM in 2018 (€62.9MM; +138.3% YoY) due to the upbeat industry trend which resulted in a higher number of residential units sold and an increase in the sale prices of these units. However, Grupo Pestana's core business (hospitality) decreased by 8.3% in comparison with the previous year and reached €203.6MM. This reduction is not a cause of concern considering the negative effect of the spin-off of its international hotel business.

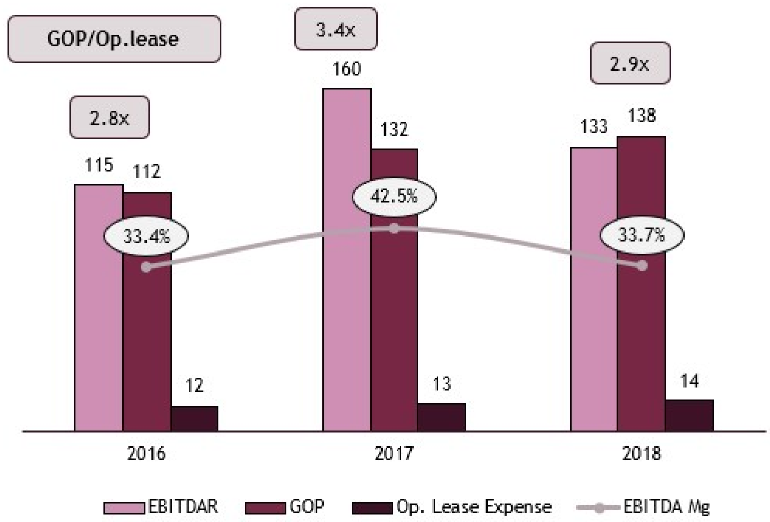
Excluding this effect, revenues would have increased by €9.3MM (+5% YoY) based on the greater number of rooms (6,293 in 2018; +86 rooms YoY) in their hotel portfolio. Additionally, the company presented a favourable evolution of vacation club business lines and those activities grouped in 'others', which have increased by 8.4% and 8.2%, respectively. By contrast, brewery business lines have performed negatively altogether (-3.1% YoY), through the decrease is not significant taking into account their low weight over total sales.

On balance, we take a positive view of Grupo Pestana's capacity to obtain recurrent business based on its leading competitive position within the Portuguese hospitality industry which enables it to take advantage of the positive dynamics of the sector in the country. On the other hand, the company's dependence on Portugal's tourist industry and especially the leisure and resort segment (Resort rooms account for 83% of total) could imply certain risks due to potential economical-political uncertainties (economic slowdown, Brexit, geopolitical and trade tensions, etc.).

Focusing on the hospitality business, Grupo Pestana showed an adequate performance across its main KPIs. Hotel Guest Operating Profit (Hotel GOP) remains strong (€89M) and the average daily rate (ADR) and occupancy levels, in spite of the slight decrease during the latter year, continue above Portugal's average of €79.8 and 65.4%, respectively.

The positive evolution of turnover has been accompanied by the maintenance of sound profitability levels which evidence the strength of Grupo Pestana's business model. Thus, the company has maintained an efficient and flexible cost structure during recent years which is reflected in its Gross Operating Profit which reached €138MM in 2018 resulting in a GOP margin of 37.8%. The company displays a relatively high coverage of its lease expenses with its operating results (GOP/Operating lease ratio of 2.9 times) which reflects a well-managed cost structure.

Profitability evolution. €MM.



Axesor Rating takes a positive view of the company's flexible cost structure, where around 50% of operating cost are variable and provide a robust resilience to down-turns. This characteristic is seen in Grupo Pestana's key figures between 2008 and 2014. From 2008 to 2010 (crisis years) the decrease in revenues (-€25MM 09vs08; -€27MM 10vs08) flowed through to GOP by 54.7% and 53.7% respectively (-€13.7MM 09vs08; -€14.7MM 10vs08), which reflects that approximately 50% of operating cost are flexible. During the recovery years (2010-2014), growth in sales was positively translated to GOP by a greater flow-through percentage than in the down turn, driven by existing economies of scale.

Company's resilience. Pestana hotels. Thousands of €.

	2008	2009	2010	2011	2012	2013	2014
Revenue	128,118	103,110	100,891	112,810	107,006	111,483	123,916
GOP	36,986	23,306	22,358	31,134	28,431	33,149	40,942
GOP %	28.9%	22.6%	22.2%	27.6%	26.6%	29.7%	33.0%
Flowthrough crisis[1]		54.7%	53.7%				
Flowthrough recover[2]				73.6%	99.3%	101.9%	80.7%

[1]Crisis phase; base year 2008. [2]Recovery; base year 2010.

EBITDA/Room analysis. Thousands of €.

	EBITDA	Rooms	Ratio
G.Pestana	79,950[1]	6,293	12.7
Accor Hotels	712,000	703,806	1.01
Meliá Hotels	326,527	98,518	3.31
Barceló	348,000	55,017	6.33
NH Hotels	263,200	54,374	4.84
Marriot[2]	2,263,755	1,317,368	1.72

[1]EBITDA hospitality. Adjusted with %GOP.

[2]Exchange rate: 1EUR=1.15USD

EBITDA reached €123MM decreasing by 15.5% due to the extraordinary capital gains recorded in 2017 arising from the spin-off of its international activity. Excluding this effect, the company continued to show a strong EBITDA margin which stood at 33.7% in line with the previous years (34% in 2017 adjusted for extraordinary results).

These outstanding operating margins are based on the company's focus on optimizing its EBITDA per room ratio which is extraordinarily above the main players of the sector. The company's long-term vision enables them to grow more profitably than its peers. Additionally, Grupo Pestana's presence in the real estate sector provides them with higher EBITDA margins due to the characteristics of this business. Although a presence in the real estate business usually implies additional risks (construction risk, sharp drops in real estate prices, high cyclicality, etc.), the company's approach to residential development limits the associated risks of this business line since construction only begins upon request and after advanced payments have been received.

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1H Results. Thousands of €.			
	1H18	1H19	19vs18
Turnover	167,125	150,181	-10.1%
EBITDA(1)	55,653	49,566	-10.9%
EBITDA Mg	33.3%	33.0%	-0.3pp
EBIT	35,471	29,081	-18.0%
EBIT Mg	21.2%	19.4%	-1.9pp
Pre-tax income	25,656	21,366	-16.7%

(1)Calculated by the company.

In 2018, the company maintained the solid trend in its profitability levels. Pre-tax income stood at €82.3MM, growing by 6.5% (excluding extraordinary results) driven by the positive operating performance (EBIT reached €92.8MM) and the improvement of its financial results (-€10.5MM; +26.2% YoY). Thus, Grupo Pestana posted a net income of €68.2MM. We value favourably the company's ability to obtain growing and sustainable results during the recent years.

In the first semester, Grupo Pestana's revenues reached €150.2MM, showing a 10.1% decrease compared to the same period a year earlier. This drop was explained by the trend in tourism in Portugal driven by the uncertainty of Brexit (the main feeder market for resort tourism in Portugal), the bankruptcy of a German airline and the recovery of other Mediterranean holiday destinations (Turkey, Egypt, etc.), which are direct competitors of the Algarve and Madeira regions. During this first half of the year, EBITDA margins suffered a slight drop of 0.9 percentage points, nevertheless, the company was still able to generate a favourable EBITDA margin of 33%, reaching a pre-tax income of €21.4M (-16.7% YoY). Axesor Rating takes a cautious view of the company's future performance under a more constrained economic scenario though mitigated by Pestana´s proven resilience to these conditions.

3.2. Financial structure and indebtedness

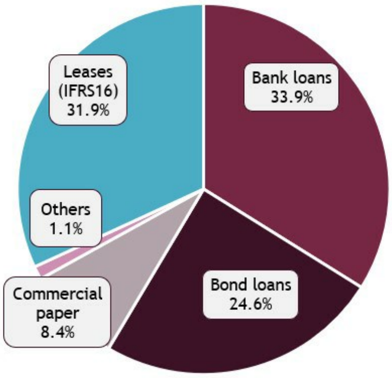
"Solid financial structure which shows an adequate level of capitalization and a controlled indebtedness. NFD/EBITDA ratio stood at 2.9 times providing the company with enough flexibility to manage its commitments."

Grupo Pestana relies on a slightly leveraged financial structure to fund its total balance of €858.6MM. The company's equity over total financial debt ratio (Equity/TFD IFRS16 adjusted) stood at 61.2% in 2018 and displayed a controlled level of debt. NFD/EBITDA ratio remained at 2.9 times (2.1x without adjusting IFRS16) which, from our point of view, shows an adequate capacity to manage its debt commitments.

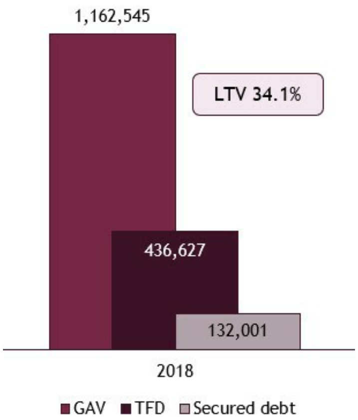
Indebtedness. Thousands of €.			
	2016	2017	2018
Equity	280,629	269,840	267,037
Equity/TFD	72.7%	90.6%	89.8%
Equity/TFD with IFRS16	57.3%	63.6%	61.2%
TFD	385,976	297,679	297,367
NFD	303,372	241,399	257,651
TFD with IFRS16	489,989	424,262	436,627
NFD with IFRS16	407,385	367,982	396,911
NFD/EBITDA(1)	3.0x	1.7x	2.1x
NFD/EBITDA(1) with IFRS16	3.6x	2.3x	2.9x
FFO(1)/NFD	29.1%	43.6%	48.1%
FFO(1)/NFD with IFRS16	21.7%	28.6%	31.2%
EBITDA(1)/Interest	4.8x	9.7x	11.3x

(1)Calculated by the company.

Debt composition. % of total.



Debt-GAV. Thousands of €.



The company has maintained an adequate financial autonomy (Equity accounts for 31.1% over total Balance). We highlight that, although there is an active dividend payment policy from Grupo Pestana to its parent PIH during the previous years (average pay-out of 73.7% in the last three years), these outflows have been fully reinvested at PIH level but have not benefited Grupo Pestana itself. Therefore, no dividends have been distributed from PIH to the shareholders which reflects ownership's commitment with the business. We believe that the company presents a significant flexibility in its dividend policy based on the commitment of the shareholders to adjust dividends, depending on the group's financial needs. There is no obligation to distribute dividends from Grupo Pestana SGPS to PIH. However, during the coming years, it is expected that the company will continue with these dividend distributions provided it maintains a balanced financial position (company's financial policy is to keep ND/EBITDA < 3.5x).

We highlight that there is no asset from Grupo Pestana that is guaranteeing any loan to PIH, except for the Pestana Promenade hotel which is pledged in favour of BBVA as a guarantee for several loans (€9.5MM). This is not a cause of concern for Axesor Rating.

Grupo Pestana has shown a solid funding term structure which is reflected by a permanent resources/fixed assets ratio above 100% in 2018. Axesor Rating takes a positive view of this, especially taking into account the company's business model, which impels it to hold a significant weight of non-current assets on its Balance Sheet (primarily due to hotels under ownership).

At year end, total financial debt reached €436.6MM (+2.9% YoY), being this debt mainly concentrated in the long-term (Non-current debt accounts for 87.9% of total financial debt), which enhances the company's solvency. Within this framework, we highlight that the debt is primarily made up of bank financing (€148MM), bond loans (€107.5MM) and operating leases (€139.3MM). This latest debt arises due to the new IFRS16 accounting rule which considers an operational lease as an on-Balance liability, reflecting the future payments to creditors (hotel owners or lessors). Grupo Pestana additionally has commercial paper programmes with an outstanding €36.8MM at year end and other financing instruments (€5MM). We highlight that the company is currently negotiating a €50MM senior unsecured bond to refinance its debt profile and extend its debt maturity schedule. Axesor Rating takes a positive view of this transaction which will provide Grupo Pestana with better financial flexibility.

They have maintained a prudent financial policy with a controlled level of debt which is also reinforced by the high GAV of its portfolio. The company's assets portfolio has a market value of €1.16Bn which could be accessed for sale to help the company under a stress scenario. This significant market value of the assets results in a Loan-To-Value ratio which stood at 34.1%, which we value positively.

Based on Axesor's Rating methodology net financial debt amounted to €396.9MM considering IFRS16 impact, resulting in a year end ratio NFD/EBITDA of 2.9x. We highlight that the company's financial policy is to progressively reduce this ratio (NFD/EBITDA forward looking for 2021, 2.2x). We consider Grupo Pestana to have enough capacity to meet adequately its financial requirements. This is also reinforced by the robust FFO/NFD and the interest coverage ratios which stood at 33.1% and 11.3 times respectively at 2018 year-end.

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"Comfortable liquidity situation based on a solid cash generation and treasury position and an adequate financial flexibility."

Liquidity. Thousands of €.			
	2016	**2017**	**2018**
Cash position	82,604	56,280	39,716
FFO[1]	88,219	105,315	123,850

[1]Calculated by the company.

Capex. €MM.			
	2016	**2017**	**2018**
Growth	42	39	39
Acquisition	5	5	39
Maintenance	5	6	4
Net capex	**52**	**50**	**82**

3.3. Liquidity and cash generation

Grupo Pestana presents a positive liquidity position, driven by a stable generation of funds from operations (FFO), a comfortable treasury position, a manageable debt maturity schedule that is long-term in nature and a favourable financial flexibility and access to the debt markets.

The company's ability to generate cash from its operations is valued positively which is reflected in stable funds from operations (FFO) during the last years. At year end, FFO stood at €123.9MM (+17.6% YoY) indicating Pestana's strong capacity to convert EBITDA into FFO (FFO/EBITDA conversion ratio averaged 94% between 2016 and 2018).

In terms of cash flow, the company shows a positive operational cash flow of €92.9MM at the end of 2018 which was enough to face its capex requirements (€82MM). During the year, Grupo Pestana's capex was mainly directed to fund growth plans (€39MM in growth capex) focus on the opening of 3 new hotels and 2 Pousadas de Portugal (24% of completion over a total estimated investment of €52MM) and the acquisition of Pestana D. Joao II Hotel in November (€39MM) which was already being operated under a lease contract. The remaining capex investments were attributed to maintenance and refurbishment capex (€4MM).

We additionally highlight the non-recurring positive impact arising from the corporate spin-off (€95.1MM) all of which resulted in a positive cash flow from investments of €13.1MM. Therefore, the company obtained a free cash flow of €106MM, however, €69.5MM of these funds were re-channelled to PIH via dividends, effectively funding PIH´s acquisition of Grupo Pestana SGPS' international business. This led to an internally generated cash flow of €38.5MM. In 2018, the financing cash outflow reached €54.4MM due to the net debt repayments and payments on interests and similar expenses which resulted in a decrease in final cash flow of €16MM.

Cash flow. Thousands of €.			
	2016	**2017**	**2018**
Cash flow from operating (CFO)	**69,529**	**107,769**	**92,837**
Cash flow from investment activities	-8,550	-6,152	13,130
Free Cash Flow (FCF)	**60,979**	**101,618**	**105,967**
+/- changes in capital	0	0	2,000
- dividend paid and profit distribution	-27,152	-97,267	-69,472
Cash Flow Internally Generated (CFIG)	**33,827**	**4,350**	**38,495**
+/- financial debt receipts/payments	15,861	-17,204	-41,499
- interest and similar expenses	-20,041	-14,976	-12,941
+/- impact of exchange rates	-2,691	3,747	17
Net cash generated	**26,956**	**-24,082**	**-15,928**
Cash ast the start of the period	52,565	79,521	55,439
Cash at the end of the period	79,521	55,439	39,511

Maturities schedule. Thousands of €.

Year	Amount	% of total
2019	47,746	16.3%
2020	86,879	29.7%
2021	43,690	14.9%
2022	28,085	9.6%
2023	32,551	11.1%
>2023	53,403	18.3%
Total	**292,354**	

The company expects to continue with its intensive investments (€27MM in average from 2019 to 2021) and an active dividend policy in the upcoming years (€23MM in average in next three years). However, it is expected that Grupo Pestana will encounter no problems in meeting its short-term commitments, and what is more, excess of cash will be used for early debt repayments. The company shows a favourable financial flexibility primarily based on their adequate access to the debt markets which will help them to cover any need in case that liquidity tensions arise.

At year end, the company's treasury position was €39.7MM which together with the available financial facilities (€68MM available credit lines +€16.5MM undrawn long-term commercial paper lines) enables them to cover comfortably their operating needs.

The favourable liquidity position enables Grupo Pestana to face, without significant difficulties, its debt maturity schedule. In 2020, there is a significant maturity (€65MM bond) which the company will seek to refinance through a bond issuance of €50MM. This issuance will reinforce the company's financial flexibility as a result of the extension of the debt maturity schedule (bullet amortization).

We expect the company will have no problems to meet its payment commitments in the short term with its available liquidity. Additionally, from our point of view, this situation will continue in the near future under a scenario of continued improvements of its business performance. On a forward-looking basis, Grupo Pestana's sources of funds cover adequately its uses in the next years.

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