BBB-

ISSUER RATING

Long-term Rating

Outlook: Stable

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Rating Action

Axesor Rating affirms Grupo Pestana's "BBB-" rating, changing its outlook from Negative to Stable.

Executive Summary

Grupo Pestana focuses its activity on the management of 80 hotels, 9 units of vacation club, 6 golf courses, 4 real estate ventures, 1 casino gambling concession and 1 brewery company, 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 106 hotel units and 6 tourist ventures, with over 12,200 rooms across 16 countries. Grupo Pestana's estimated turnover in 2021 is €253.7MM (+55.5% YoY) with an EBITDA of €81.1MM (32% EBITDA Margin). NFD/EBITDA is expected to stand at year end in 4.8 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 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.

Fundamentals

Business profile

- **High exposure to the tourist industry, severely impacted by COVID-19 crisis, which however, begins to show signs of recovery.**

  The tourism and hospitality sectors were directly affected by the crisis given their exposure to falling consumer demand, travel restrictions and the downward turn of the economy (high correlation with the economy). As a result, the industry has suffered a drastic decline in its volume of activity in 2020. However, after a slow start (1Q21), recovery gained pace during 2021 primarily driven by the progress in vaccination and the reopening of the borders. Although, a complete return to pre-pandemic levels is not expected until 2023, we value positively the industry dynamic during recent months. However, it is worth highlighting that the recent surge in COVID-19 cases around Europe and the emergence of the Omicron variant could bring uncertainties for the industry in the upcoming months.

- **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.

- **Activity historically concentrated on the hotel industry in Portugal which has shown a rise in the real estate business during the last years.**

  Traditionally, hospitality has been the company's main source of business. This activity has been constrained by its lack of geographic diversification beyond Portugal and a hotel portfolio which is concentrated on 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 historically diversified feeder markets (in 2019, 34% of guests originated in Portugal with the remaining 66% coming from the UK, Germany, the US, etc.). Nevertheless, it is worth highlighting that the group, as part of its diversification strategy in the last years, it has shown a real estate division which has gained relevance. This strategy, which has been supported by the success of its real estate business, has been vital to offset the consequences of the COVID-19 crisis in the hospitality sector.

- **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% 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.

- **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. 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

- **Gradual recovery of the activity and profitability levels.**

  COVID-19 crisis severely impacted the company's business and results in 2020. Grupo Pestana's top line stood at €163.1MM, decreasing by €186MM during the year, and its EBITDA reached €41.9MM (-68.2% YoY). This significant slowdown led to a negative EBIT an EBT at year end (-€7.9MM and -€23.5MM, respectively). Nevertheless, it is worth highlighting the resilience shown by the company during the year favored by its business diversification (holiday real estate development) and flexible cost structure, achieving much more limited losses than the main European hotel groups. This has allowed Grupo Pestana to offset the impact of the negative results on its equity levels. During 2021, the progressive lifting of restrictions in Europe has permitted a growing recovery of the hotel business (relevant improvement of the main hotel KPI's). Within this scenario, the company's turnover reached at the end of the 3Q21 €176.9MM, with an EBITDA of €56.6MM (32% EBITDA margin) which has allowed them to generate a positive result (EBT €13.4MM).

- **Balanced financial structure and valuable portfolio of assets which mitigate the significant deterioration of the leverage & coverage ratios.**

  As a consequence of the crisis, the company has suffered a significant deterioration in its leverage and coverage ratios, NFD/EBITDA and EBITDA/Interest stood at 9.9x and 2.6x in 2020, levels which are valued as weak. However, from our point of view, this is mitigated by a well-balanced financial situation, reporting the company adequate equity over total financial debt levels (Equity/TFD ratio of 57.8% in 2020), and specially a highly valuable asset portfolio (~€1.17Bn; LTV of 41.5%), which could be accessed for sale to help the company under a stress scenario. These solid fundamentals together with the progressive recovery of leverage and coverage ratios during 2021 (NFD/EBITDA LTM and Interest coverage of 6.4x and 4.9x, respectively at the end of 3Q21), make us consider Grupo Pestana's capacity to meet its financial requirements as positive.

- **Adequate capacity to meet the financial and investment requirements.**

  Grupo Pestana presents a positive liquidity position backed by an adequate treasury position (€49MM in cash + €82MM in undrawn credit facilities and commercial paper in 3Q21), a funds from operations recovering from the extraordinary 2020, a favorable financial flexibility (access to debt markets) and a debt maturity schedule long-term in nature (60.7% of financial debt matures in 2025 and onwards). From Axesor Rating's point of view, these fundamentals ensure the company's capacity to cover its financing and investment needs with no expected liquidity tensions in the short-term.

Main financial figures

Main financial figures. Thousands of €.	2019	2020	3Q21	2021E	21Evs20
Turnover	349,093	163,105	176,879	253,654	55.5%
EBITDA[1]	131,610	41,897	56,624	81,111	93.6%
EBITDA Margin	37.7%	25.7%	32.0%	32.0%	6.3pp
EBT	82,196	-23,482	13,388	24,162	202.9%
Total Assets	1,076,794	962,715	998,654	1,032,994	7.3%
Equity	310,749	272,440	268,586	276,882	1.6%
Total Financial Debt	503,508	471,607	497,506	521,824	10.6%
Net Financial Debt	388,446	413,825	448,522	391,454	-5.4%
Loan To Value[2][3]	33.1%	41.5%	42.8%	35.6%	-5.9pp
NFD/EBITDA	3.0x	9.9x	6.4x[4]	4.8x	-5.1x
Funds From Operations	120,288	18,901	42,741	61,238	224.0%
FFO/NFD	31.0%	4.6%	9.4%[4]	15.6%	11.1pp
EBITDA/Interest	7.8x	2.6x	4.9x	5.4x	2.7x

[1]EBITDA Normalized, excluding capital gains from the sale of assets to holding company (PIH). [2]Secured debt of €122.5MM in 2019 and €150MM in 2020. [3]Estimated GAV includes adjustments in 2020, 3Q21 and 2021 due to COVID-19. [4]EBITDA and FFO LTM (3Q21 + 4Q20).

Rating and Outlook

Axesor Rating affirms Grupo Pestana's "BBB-" rating, changing its outlook from Negative to Stable. The better-than-expected recovery of the activity as of the first quarter of 2021 has allowed the company to show a significant improvement of its main financial ratios in comparison with 2020 (higher EBITDA, positive results and gradual recovery of its leverage and coverage ratios). This positive evolution, together with the strong business fundamentals of the company that are expected to allow them to take advantage of an industry which is projected to maintain a recovery dynamic, should lead the company to a gradual return to a more normalized situation. Although changes in the rating are not expected in the short-term, the resurgence of COVID-19 infections in Europe and the new Omicron variant are risks which are going to be continuously monitored by Axesor Rating.

Rating sensitivities

Detailed below are the factors that individually or collectively would impact company's rating:

- **Positive factors (↑).** Maintenance of the recovery dynamic in the industry. Lower NFD/EBITDA ratio. Improvement of the equity levels. Reinforcement of the liquidity position driven by a recovery of its free cash flow generation.
- **Negative factors (↓).** Setback in the recovery of the tourism industry. Lower than expected recovery of the business. Increase in the NFD/EBITDA ratio. Negative results that would erode financial autonomy levels. Maintenance of a constrained capacity to generate operating cash flow.

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, 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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