GRUPO PESTANA SGPS SA

PT511220448 CORPORATE

BBB+ ISSUER RATING
Long term

OUTLOOK
Stable

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Rating Action and Rationale

- EthiFinance Ratings upgrades Grupo Pestana, SGPS, S.A's rating from "BBB" to "BBB+", maintaining a Stable outlook.
- The change in the rating is based on the positive evolution of all financial metrics in 2023 and in the first nine months of 2024 evidenced by a lower indebtedness level, higher solvency, and a stronger interest coverage ratio.
- The rating is supported by a solid financial profile, including the excellent level of indebtedness (NFD/EBITDA ~1.2x and FFO/NFD c70% on average), together with a strong loan-to-value ratio (c22% on average).
- On the other hand, the rating is constrained by the still modest size of the company, which affects its overall competitive positioning, together with its high exposure to the Portuguese market, and the leisure segment. In addition, its ownership structure limits the amount of financial support potentially available in stress scenarios, although it does also mean stability and continuity.
- In line with our methodology, the hotel sector presents a medium to low ESG risk (sector heatmap score between 2.0 and 2.9), given its limited impact on the environment. This assessment has a neutral impact on the sector assessment. The company's ESG policy is considered to be adequate (company ESG score between 1 and 4), also resulting in a neutral impact on the overall rating.

Issuer Description

Grupo Pestana, SGPS S.A is a Portuguese company, founded in 1972, which focuses its activity on the tourist sector. The company is the Portuguese subsidiary of Pestana International Holding (PIH), the largest group in the hospitality business in Portugal. The company manages 76 facilities in Portugal under Pestana Hotels, Pestana Collection, Pestana CR7, Pousadas de Portugal, and Pestana Residences brands. This is complemented by real estate activities, golf courses, and the Casino da Madeira. The company's 2023 turnover was €457.1m (+21.7% YoY), with an EBITDA of €146m, and an EBITDA margin of 31.9%. NFD/EBITDA stood at 2.0x. In 9M2024, the company's turnover amounted to €364m, with EBITDA of €147.1m, and an EBITDA margin of 40.4%. NFD/EBITDA LTM was down to 1.3x.

In assigning the rating, financial projections for the period 2024-2026 have been taken into account. The company considers this information to be confidential and therefore it has not been reflected in this report.

Fundamentals

Business Risk Profile

Industry Risk Assessment

- **Sector characterized by high profitability margins with medium volatility, significant entry barriers, and favorable growth prospects.**

Although the market has a large number of players, entry barriers are considered high due to the substantial know-how, experience, brand recognition, and initial investment required to be competitive. This results in an industry with elevated profitability margins (EBIT margin between 13%-18%). The evolution of the hotel industry highlights its connection to the macroeconomic environment (profitability margins show medium volatility). In recent years, the sector has been impacted by the COVID-19 crisis, though it has shown a gradual recovery from 2022 onwards. At EthiFinance Ratings, we believe the sector has favorable growth prospects, driven by the consolidation of its recovery, and society affinity for travel. However, the macroeconomic scenario presents some geopolitical uncertainties, which could influence the sector's performance, and lead tourists to adopt a more cautious approach.

- **The sector has low exposure to ESG risks (sector heatmap score between 2 and 2.9).**

The hotels & leisure sector has medium to low ESG risks under our methodology (sector heatmap score between 2 and 3). This results in a sector assessment that is not impacted by industry-related considerations. Regarding environmental factors, the sector has a medium impact on climate, mainly linked to scope 3 emissions generated by travel and/or the construction of large infrastructures. Resources can have a limited impact on financials, as scarcity in local areas can affect companies (e.g. water). The impact on pollution is also limited, except for the cruise and hotels industries where waste issues exist. However, the sector can sometimes have a negative social impact, linked to malpractices such as overbooking, poor quality of service, noise, etc. Regarding communities, tourism can be an important source of revenues and local communities can benefit from this industry.

Competitive Positioning

- **Despite the small size of Grupo Pestana relative to the main competitors worldwide, the company has a leading competitive position at a national level.**

Although Grupo Pestana is the largest hotel company in Portugal, it is still far from global hotel chains such as Meliá and NH Hotels, which is evident in terms of turnover, numbers of hotels and rooms. Pestana Hotel Groups is ranked 105th (vs Meliá Hotels and NH Hotels, ranked in 25th and 29th, respectively). However, it is a national reference player, standing out by its number of hotels and rooms in Portugal. The company has a high level of brand recognition (Pestana Hotels and Resorts, Pestana Pousadas de Portugal, Pestana Collection and Pestana CR7Lifestyle hotels) supported by its presence in touristic areas. These well-known brands are mainly concentrated in upscale (52%) and upper upscale (39%) segments, although with 8% dedicated to the luxury segment. The presence in the last two segments stands out, given the greater associated added value and differentiation. These factors partially explain the higher profitability margins (EBIT margin between 25%-28%) in comparison to the average of the sector.

- **Good diversification supported by unique locations and varied feeder markets.**

The Portuguese subsidiary is mostly concentrated in the leisure segment (resort rooms represent 80.8% of the total rooms at Septembre-2024), given its presence in tourist areas (Lisbon, Porto, Algarve, and Madeira).We positively value that a significant portion of those resorts are in unique locations, with views of the Atlantic Ocean, or in places where it is no longer possible to build more hotels, including strategic locations. This geographical concentration is also partially mitigated by well-balanced feeder markets, highlighting that only 28% (31% in 2023) of 9M2024 customers are from Portugal, with the remaining 72% (69% in 2023) from abroad.

Shareholder Structure and Governance

- **Family ownership structure.**

The ownership structure remains in the hands of Mr. Dionísio Pestana, son of the founder of the group, and being involved in the business since 1976. Although the ownership structure limits the amount of financial support potentially available, in the event of a need arising; it does also mean stability and continuity. In addition, Grupo Pestana SGPS S.A can potentially benefit from the greater size of Pestana International Holdings S.A.

- **Qualified management team and prudent financial policy.**

Despite the concentration of ownership and decision making, we highlight the extensive professional background of the members of the management team. This has been a key in the positive performance of the company in the recent years, leading the company to position itself as the reference player in the Portuguese market. In addition, financial policy is characterized by controlled debt levels (NFD/EBITDA below 1.5x), and strong financial autonomy (equity/TFD above 120% and LTV below 25%).

- **Neutral ESG Policy.**

Grupo Pestana has a neutral ESG exposure (score of 1.80). ESG issues are already considered and managed, leading to a low probability of occurrence of an ESG related impact on revenues, results, cash flows, asset value or reputation. Governance policies are strong, marked by a qualified board of directors with separation of roles, public disclosure of policies (business code of conduct and corruption policy), and prioritization of ESG issues. This is also reinforced by good environmental metrics although with social metrics below average.

Financial Risk Profile

Sales and Profitability

- **Positive evolution of revenues together with good profitability margins.**

In 2023, the group achieved record revenues and EBITDA of €457.1m and €146m, respectively. However, EBITDA margin decreased to 31.9% affected by intercompany real estate sales to PIH, assets sold at market value with near to no profitability (the EBITDA margin, excluding this impact, will reach 34%, similar to 2022 figures). EBIT stood at €105.2m (EBIT margin of 23%) and EBT at €91.5m, 21.2% below the previous year, the 2022 figures benefited from the sale of the Pestana Blue Alvor All Inclusive hotel, which generated an exceptional gain of €40m.

In 9M 2024, revenues reached €364m due to the positive evolution of the hospitality business line, but with a lower volume in the real estate business line. This contributed to higher profitability margins, resulting in an EBITDA margin of 40.4% (+4.1pp vs 9M 2023). EBITDA reached a record €147.1m (+11.4% YoY; +0.8% vs total annual EBITDA in 2023). The positive evolution led to higher EBT (+15% vs 9M 2023).

Revenues are estimated to increase to €562m in 2024 (+22.9% YoY) due to real estate projects in the last quarter of 2024, consolidating an EBITDA margin of c36%. For 2025, the company estimates relatively stable revenues of €551.7m, with a lower EBITDA margin of 31.5% affected by transactions in the real estate business line. If this effect were excluded, EBITDA margin in 2025 would remain stable between 34% and 35%.

Leverage and Coverage

- **Outstanding leverage level and good interest coverage ratio.**

Net financial debt remained relatively stable in 2023 (+4% YoY), marked by the reduction of cash and equivalents (75.6% YoY) used to repay financial debt. However, the increase of EBITDA (+13.8% YoY) led to a slightly more controlled indebtedness level (NFD/EBITDA of 2.0x, 0.2x below previous year), and a higher interest coverage ratio (EBITDA/interest of 8.9x, +1.5x above previous year). Based on figures as of September 2024 figures, the NFD is further reduced by 11% compared to December-2023 figures, benefiting from the stronger generation of cash and equivalents (+93.9% vs December 2023). This, together with an estimated higher profitability margin in 2024, resulted in an NFD/EBITDA ratio of 1.3x at end-September 2024. The stronger profitability margins achieved in 9M2024 also improved interest coverage to 13.4x.

For the year ending 2024, the NFD/EBITDA ratio is estimated to remain close to 1.1x, with an interest coverage (EBITDA/interest) of c14.5x, which is assessed favorably. The company's objective is to progressively reduce external financing, until a positive net cash position can be achieved.

Cash Flow Analysis

- **Positive and strong FCF for FY23 and 3Q24 to support the group's growth.**

CFO generation was strong at €155.2m in 2023 and €116.6m in the first nine months of 2024 allow it to continue investing in the new hotels and the refurbishment of the existing ones, while maintaining positive FCFs of €62.1m and €70.2m, respectively. The excess of liquidity at the end of December-2023 allowed the payment of high dividends to PIH to continue the group's growth in other countries, and the repayment of debt. Apart from all these regular outflows, we highlight that the company remained with a strong position of cash and equivalents of €41.4m at December-2023, and €80.2m at September-2024.

Solvency

- **Excellent level of solvency.**

The group continues to strengthen its financial autonomy, with equity equivalent to 104.1% of total financial debt in 2023 (vs 79.5% in 2022). In 2023, total financial debt reduced by 25.8% due to the payment, in advance, of debt remunerated at a variable rate (€49m), and the redeemable of the bond signed in September 2019 (€32.9m), supported by the high liquidity available at December 2022. This offset the slight reduction of equity (-2.8% YoY), given the high dividends payout to the PIH in 2023 (net income of €85m vs dividends payout of €95m). We also highlight the GAV of the company's portfolio as a significant strength that reinforces its solvency (LTV of 21.6% on average).

Liquidity

- **Good liquidity and strong refinancing profile.**

Pestana Group has a good capacity to meet its commitments in the short term, supported by its ability to generate stable and recurring cash flows from its operations (CFO estimated at €154.6m in 2024), and an estimated prudent strategy in terms of investments and dividends payout to the holding company (PIH). This, together with the cash and equivalents at December 2023 (€41.4m) and undrawn credit lines (€88.6m), provide it with good liquidity to meet short-term payment obligations (€32.5m at December 2023). In addition, the company has a strong refinancing profile, which is relevant in a stress scenario.

Modifiers

Controversies

- **The group does not have any relevant controversies at the moment.**

Country Risk

- **No relevant country risk has been identified.**

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Main Financial Figures

Main financial figures. Thousands of €.	FY21	FY22	FY23	23vs22
Turnover	262,187	375,443	457,100	21.7%
EBITDA	75,777	128,255	145,979	13.8%
EBITDA Margin	28.9%	34.2%	31.9%	-2.2pp
EBIT	46,578	133,107	105,163	-21.0%
EBIT Margin	17.8%	35.5%	23.0%	-12.4pp
EBT	30,950	116,121	91,450	-21.2%
Total Assets	1,001,553	1,089,971	977,687	-10.3%
Equity	287,036	361,157	351,043	-2.8%
Total Financial Debt	492,113	454,062	337,100	-25.8%
Net Financial Debt	417,975	284,237	295,690	4.0%
Equity/TFD	58.3%	79.5%	104.1%	24.6pp
NFD/EBITDA	5.5x	2.2x	2.0x	-0.2x
Funds From Operations	64,998	116,103	112,674	-3.0%
FFO/NFD	15.6%	40.8%	38.1%	-2.7pp
EBITDA/Interest	4.7x	7.4x	8.9x	1.5x

Credit Rating

Credit Rating	
Business Risk Profile	**BBB-**
Industry risk assessment	*BBB*
Industry's ESG	*Neutral*
Competitive Positioning	*BB+*
Governance	*BBB-*
Financial Risk Profile	**A-**
Cash flow and leverage	*A-*
Solvency	*A+*
Company's ESG	Neutral
Anchor Rating	**BBB+**
Modifiers	*No*
Rating	**BBB+**

Rating Sensitivity

- **Long-term rating positive factors (↑)**

The company would need to show improvement in adjusted debt and interest coverage levels (NFD/EBITDA below 0.5x, FFO/NFD above 85% and EBITDA/interest above 18x on average), and increase in solvency levels (LTV below 15% on average). An improvement on the ESG score could also benefit the overall rating. However, it is important to note that the corporate rating is always capped at the rating of Portugal, which is rated at A- by EthiFinance Ratings.

- **Long-term rating negative factors (↓)**

The deviation from the conservative scenario estimated for 2025-2026, e.g. higher dividend payout to PIH and/or higher expansion CAPEX could lead to lower cash generation and the deterioration of financial metrics. In general, deterioration of adjusted debt levels (NFD/EBITDA above 1.5x, FFO/NFD below 65%, and EBITDA/interest below 10x on average) and solvency levels (LTV above 25% on average) could prompt a downgrade.

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, 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. Principal methodology used in this research are :
  - Corporate Rating Methodology - Long Term : https://www.ethifinance.com/download/corporate-rating-methodology-general/?wpdmdl=35203
- The rating scale used in this report is 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.