Falkensteiner Michaeler Tourism Group AG
Austria, Tourism/ Real Estate

B STABLE

Corporate profile

Falkensteiner Michaeler Tourism Group AG (FMTG) is a hotel and tourism services operator and real estate project developer, founded in 1995, with a focus on Central Europe. The company is jointly owned by the Falkensteiner and Michaeler families. The company plans and constructs hotels and apartments, and develops and operates the facilities thereafter. The corporate structure aims to capture synergies between the two divisions in its main geographies of Austria, Croatia and Italy. With about EUR 100m in consolidated revenues, largely generated by more than 30 hotel facilities in six European countries, FMTG is a relatively small and geographically specialised provider of tourism services and related real estate development.

Key metrics

		Scope estimates		
Scope credit ratios	**2016**	**2017F**	**2018F**	**2019F**
EBITDA/ cash interest cover (x)	2.7x	2.2x	2.0x	2.3x
Scope-adjusted debt (SaD) /EBITDA	13.1x	13.6x	11.8x	10.4x
Scope-adjusted FFO/SaD	4.8%	3.5%	4.5%	5.0%

Rating rationale

Scope Ratings affirms B issuer rating to Austria-based FMTG. The rating Outlook is Stable.

The issuer credit rating of B mainly reflects FMTG's relatively small absolute size, its comparatively undiversified corporate structure, highly leveraged balance sheet (although this has been improving over recent years) as well as Scope's view of operational and project-related risks in the real estate division with regard to the opening of new hotels. The rating also continues to reflect our understanding that the company will continue to be able to roll over its relatively sizeable uncommitted short-term bank lines in the future.

The rating is supported by FMTG's positive track record with regard to sales growth, as well as by its comparatively high operating margins in a peer context. Scope expects FMTG's revenues in 2017 to have grown by about 9%, supported by good underlying tourism demand with a better capacity utilisation of existing facilities as well as by the addition of new hotel projects. The FMTG group's EBITDAR margin (earnings before interest, taxes, depreciation, amortisation and rents) is likely to have been about 20% in 2017, which is fairly stable compared to the two past years. While the company managed to record satisfactory revenue growth in 2017, operating profit was burdened by project delays in the modernisation of the Stegersbach and Punat hotels. Rating support is further provided by our belief that the tourism industry has relatively little cyclical exposure and is protected, in our view, by medium risk regarding barriers to entry.

While sales growth – in combination with divestiture proceeds for real estate and hotels – has also translated into profit growth over recent years, debt is likely to increase in the current year due to heavy investments in Croatian hotel projects.

Ratings & Outlook

Corporate rating	B/Stable
Short-term rating	-

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Related methodology

Corporate Rating Methodology, January 2018

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Scope notes FMTG's relatively high exposure to short-term credit lines of about EUR 35m annually, consisting predominantly of short-term project-finance debt secured by real estate.

This exposure is largely uncovered by corporate liquidity and there is a notable absence of committed credit lines. However, we note that committed lines are hardly used in Austria and expect the real estate security on short-term debt to keep FMTG from suffering a liquidity crisis should short-term bank lines not be extended. Scope expects FMTG to at least maintain its comparatively high EBITDAR margin.

Outlook

The Outlook is Stable and reflects Scope's expectation that FMTG can, at the least, maintain its level of profitability and that it will be able to roll over its sizeable short-term credit lines on a yearly basis. The rating reflects our expectation of an EBITDA interest cover of 2x or higher. A higher rating could result if the company progressed in realising projected sales and cash flow growth in the coming two years, and if the EBITDA interest cover reached above 3x, on a sustainable basis. A negative rating action could result from liquidity problems, created by either lower future revenue generation or a non-extension of existing short-term debt maturities. It could also be triggered by the EBITDA interest ratio falling below 2x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Positive track record with regard to revenue growth • Comparatively good operating margins • Credit-supportive underlying tourism industry	• Small absolute scale • Aggressive growth strategy • Highly leveraged balance sheet • Limited free cash flow generation

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Attaining critical size • EBITDA cash interest cover above 3x • Improved liquidity profile	• Financial policy to include acquisitions • EBITDA cash interest cover under 2x

Financial overview

		Scope estimates		
Scope credit ratios	**2016**	**2017F**	**2018F**	**2019F**
EBITDA/ cash interest cover (x)	2.7x	2.2x	2.0x	2.3x
Scope-adjusted debt (SaD)/EBITDA	13.1x	13.6x	11.8x	10.4x
Scope-adjusted FFO/SaD	4.8%	3.5%	4.5%	5.0%
FOCF/SaD	1.1%	-1.4%	-2.4%	-0.2%
Scope-adjusted EBITDA in EUR m				
EBITDA	9.9	6.5	10.1	11.6
Operating lease payments in respective year	15.6	16.0	18.5	20.5
Scope-adjusted EBITDA	25.5	22.5	28.6	33.1
Scope-adjusted funds from operations (FFO) in EUR m				
EBITDA	9.9	6.5	10.1	11.6
less: (net) cash interest as per cash flow statement	-3.6	-3.0	-5.0	-5.0
less: cash tax paid as per cash flow statement	1.1	0	0	-0.5
add: depreciation component operating leases	8.6	7.2	10.0	11.3
Scope-adjusted funds from operations	16.0	10.7	15.1	17.4
Scope-adjusted debt in EUR m				
Reported gross financial debt	92.4	96	109	106
less: cash, cash equivalents	0	0	0	0
add: operating lease obligation	192	160	180	190
Contingencies	50	50	50	50
Scope-adjusted debt	334	306	339	346

Business risk profile

Combined real estate – tourism approach

Scope's rating aims to reflect FMTG's complete corporate structure. By assessing risks and opportunities separately for the tourism and real estate divisions, the rating reflects our perception of relatively high project and execution risks for the group compared to a focused approach on tourism.

Aggressive growth strategy

FMTG has been expanding rapidly in recent years, as part of the management's growth strategy. In 2016, total sales rose by about 30%, year-on-year, followed by a likely 9% growth for 2017 (about 8% in the first nine months of 2017, year-on-year). This was achieved by higher demand for the company's existing hotel facilities as well as by opening previously developed new projects such as Capo Boi or Jesolo in Italy.

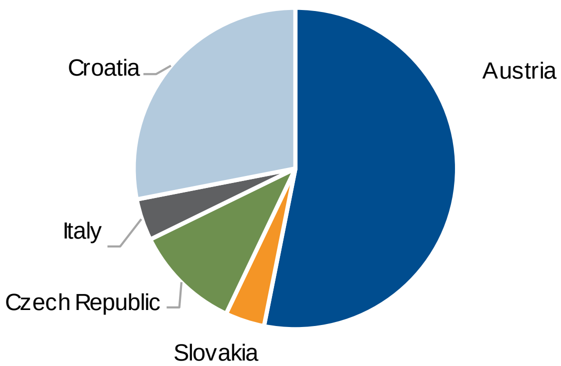
Mix of cyclical and non-cyclical industries

In Scope's view, the tourism industry has largely non-cyclical characteristics (despite a high event-risk dependence) which is offset for the group by the project and execution risks from its real estate division. Given FMTG's relatively small size and ambitious growth plans, we have adopted a relatively cautious approach to future upside from a ratings point of view.

Small market shares but focused exposure

Despite significant growth, FMTG is still a relatively small player in the hotel management market in Europe. Consolidated revenues are about EUR 100m (around EUR 170m on a managed-revenues basis), and the company realised more than 80% of revenues in Austria and Croatia. If the management can continue to generate growth over the coming years, market shares are likely to rise, in our opinion, but FMTG will remain a relatively small player in a peer group context.

Figure 1: Breakdown of revenues 2017



Good profitability

With fairly stable operating margins of 20% in 2017 (based on EBITDAR), FMTG not only compares favourably to tourism peers, but also to much larger competitors, such as NH Hotels, or MELIA with a comparable margin. This might be explained by FMTG's greater holiday exposure vis-à-vis the city hotel market which we understand is significantly less profitable. Scope believes group margins could rise to about 23% in 2018, based on further sales increases and a stronger mix of higher-quality business. The company has recently increased the quality mix of its hotel portfolio by upgrading facilities to four star level (Jesolo, Stegersbach). In addition, group profitability may benefit in 2018 if project delay-related costs, which depressed profits in 2017, can be avoided.

Diversification less developed

Scope regards FMTG's diversification as average, based on our below-average assessment of its product diversification (active only in tourism and related services) offset by better diversification from a geographical point of view. However, as about 80% of sales are generated in two countries, the company again compares unfavourably to peers.

Based on the above, Scope assesses FMTG's business risk profile as B+, supported by the company's good operating margins and little cyclicality in the tourism industry, partly offset by FMTG's small absolute size as well as risks embedded in its real estate division.

Financial risk profile

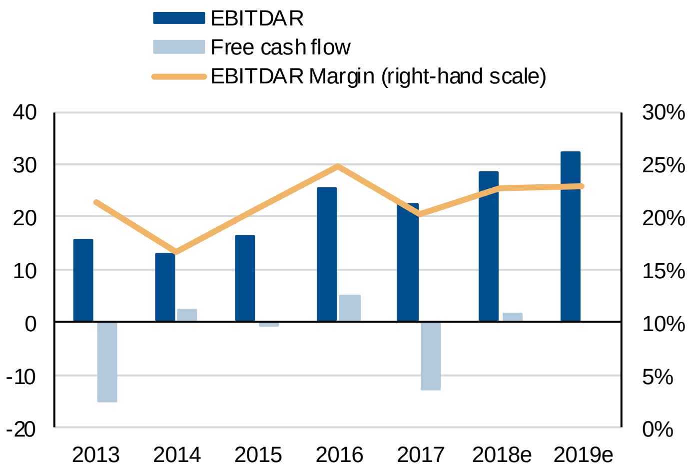
Highly leveraged balance sheet ...

FMTG's highly leveraged balance sheet is a direct consequence of its business mix. The management's historical focus on real estate purchases of hotel locations and the 'inhouse' development of construction projects has resulted in double-digit leverage ratios. As development work per se is cash absorbing at an early stage without generating cash flows, looking at the whole project's debt compared to operating cash flows would provide a distorted picture for the group. Moreover, in FMTG's case, total adjusted debt consists of operating leases and contingencies (guarantees and the like), which inflate total adjusted debt, but are significantly less important from an economic (i.e. cash-effective) point of view.

… but cash interest cover is more significant

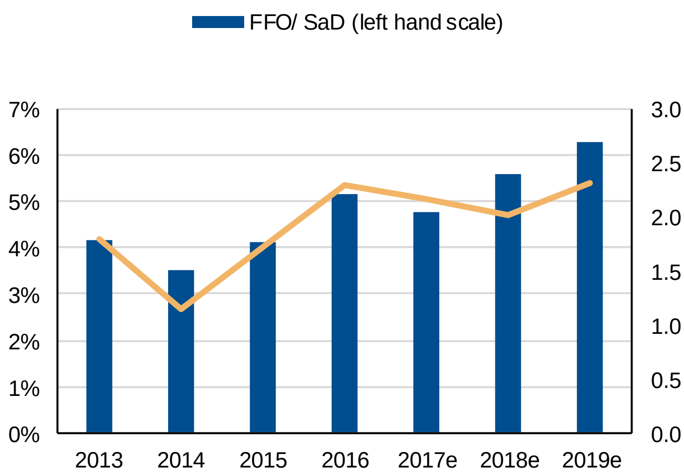
Leverage ratios such as Scope-adjusted debt (SaD) to EBITDA and funds from operations (FFO) to SaD are still clearly in the highly leveraged area and reflect the project-related debt of FMTG's real estate business. In order to more accurately capture the cash impact of high-yield ratings on the financial risk profile, we look at the EBITDA/cash interest cover. In this regard, the levels achieved by FMTG (see Financial Overview on page 2) are reflective of a B rating.

Figure 2: Profit recovery expected in 2018



Source: Scope estimates

Figure 3: Stable interest cover

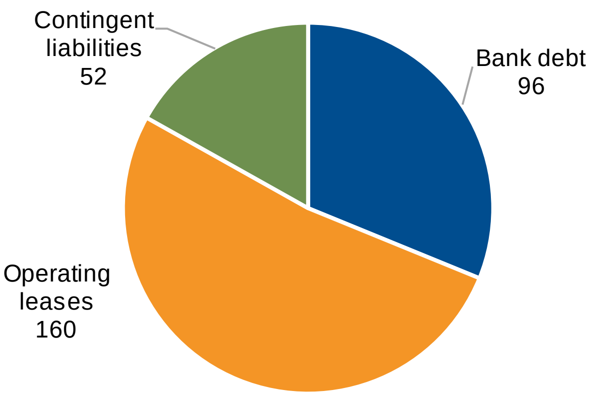


Source: Scope

Unusual liquidity profile

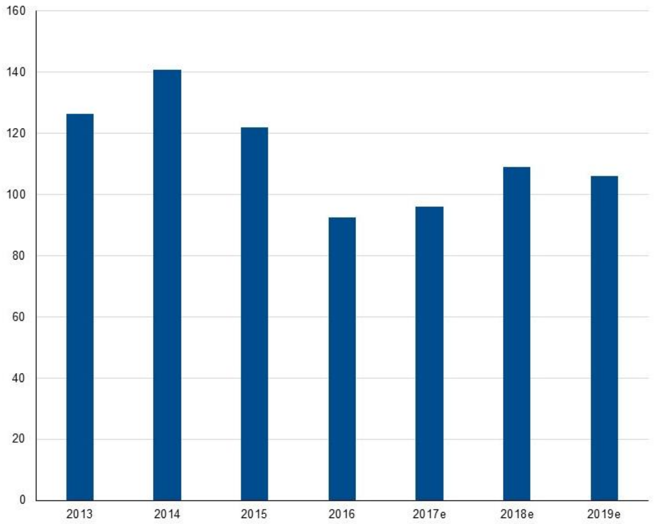
Scope regards FMTG's liquidity profile as unusual, given its seemingly large 'uncovered' portion of short-term debt of about EUR 35m (reduced in 2016 due to the repayment of the Erste Bank loan). However, as this largely pertains to project debt secured by real estate, Scope believes this effectively 'cushions' against unforeseen liquidity calls, and expects banks to continue rolling over the lines, as supported by historical evidence. We thus assess FMTG's liquidity as adequate, although not yet comfortable.

Figure 4: Scope-adj. debt breakdown, 2017F (EUR m)



Source: Scope

Figure 5: Projected development of financial debt (EUR m)



Source: Scope

Financial risk profile: B

While the company's financial debt has decreased since 2015 as expected, it is likely to increase again during 2018 through the development of hotel projects, mainly in Croatia (Borik and Punat). The strong deleveraging in 2016 was a consequence of higher cash flows from operations and divestitures of real estate.

Scope's definition of total adjusted debt also comprises operating leases of EUR 160m in 2017, based on our understanding of total rental charges of about EUR 16m in 2017 (the resulting multiple of 10 reflects our estimate of the average length of leasing contracts). It also consists of EUR 50m in contingent liabilities which comprise guarantees of the holding company.

Based on the above, Scope assesses FMTG's financial risk profile as equivalent to a B rating, mainly due to the group's relatively low cash interest cover by EBITDA as well as its high reliance on short-term debt.

Outlook

Outlook: Stable

The Stable Outlook reflects Scope's expectation of ongoing growth in the company's revenue and EBITDA, based on positive acquisition-related effects and a solid economic environment. In 2018, we expect SaD/EBITDA to improve to around 1.7x and free operating cash flow/SaD to about 23%. These levels accord with our rating Outlook and a BBB financial risk profile.

A higher rating may be triggered if the EBITDA margin is sustained above 15%, combined with a SaD/EBITDA of less than 1.5x and an FFO/SaD of above 50%. We currently view the probability of a positive rating action as remote.

A negative rating action could result from worsened trading conditions, such as increased feedstock prices leading to a single-digit EBITDA margin; or from the initiation of large, debt-funded M&A. An increase in SaD/EBITDA to above 3.0x or a decrease in FFO/SaD to below 30%, both on a sustained basis, may also prompt downgrades.

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