Falkensteiner Michaeler Tourism Group AG
Austria, Tourism/Real Estate

SCOPE 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 of consolidated revenues, largely generated through more than 30 hotel facilities in six European countries, FMTG is a relatively small and geographically specialised provider of touristic services and related real estate development.

Rating

Corporate Rating	B
Outlook	Stable

Rating rationale

Scope Ratings assigns issuer rating of B to Austria-based Falkensteiner Michaeler Tourism Group AG ('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, its highly leveraged balance sheet – although with an improving trend over recent years, as well as Scope's view of the operational and project-related risks in the real estate division with regard to new hotel openings. The rating also reflects the company's formerly tight liquidity situation, and our understanding that the company's recourse to continuous roll-over of uncommitted short-term bank lines will be possible 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. It is also supported by our belief that the tourism industry has relatively little cyclical exposure and is protected, in our view, by a medium risk regarding barriers to entry. FMTG is likely to have realised more than 25% of revenue growth in 2016, due to better capacity utilisation and the opening of new facilities. While this – in combination with substantial divestiture proceeds - has also translated into higher profits and FMTG reaching positive free cash flow status, debt is likely to increase in the current year due to heavy investments in Croatian hotel projects.

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. While this exposure is largely uncovered by corporate liquidity and, most notably, there is an absence of committed credit lines, we note that committed lines are hardly used in Austria, and expect the real estate security on the short-term debt to keep FMTG from suffering a liquidity crisis in case the short-term bank lines would not be prolonged. Scope expects FMTG to at least maintain its comparatively high EBITDAR margin and to return to free cash generation in 2018.

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Related Research // Methodology

Rating Methodology: Corporate Ratings, January 2017

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Outlook

The Outlook is Stable and reflects Scope's expectation that FMTG can at least maintain its level of profitability and will be able to roll over the 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, generated by either lower future revenue generation or a non-prolongation 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	Negative
Credit-supportive underlying tourism industry	Small absolute size
Positive track record with regard to revenue growth	Highly leveraged balance sheet
Comparatively high operating margins	Real estate project risk

Rating-change drivers

Positive	Negative
Realisation of projected sales growth	Further project risk
Deleveraging	Inability to divest real estate
Improved liquidity assessment	

Financial overview

Figures in EUR m		Scope estimates		
P&L statement	**2015**	**2016E**	**2017E**	**2018E***
Sales	78.8	100.0	113.8	116.3
EBITDAR	17.5	22.1	26.1	28.8
Cash interest paid	4.2	4.5	5.5	5.5

		Scope estimates		
Balance sheet	**2015**	**2016E**	**2017E**	**2018E**
Senior financial debt	125.0	91.0	120.0	120.0
Operating leases	90.0	120.0	150.0	150.0
Contingent liabilities	52.0	52.0	52.0	52.0
Scope-adjusted debt (SaD)	267.0	263.0	322.0	302.0

		Scope estimates		
Cash flow statement	**2015**	**2016E**	**2017E**	**2018E**
Funds from operations (FFO)	13.5	17.3	20.3	22.0
Changes in working capital	2.0	1.0	-3.0	0.0
Capital expenditure	-3.1	-2.0	-26.0	-2.0
Free cash flow	0.1	5.1	-23.2	4.5

		Scope estimates		
Key financial ratios	**2015**	**2016E**	**2017E**	**2018E**
EBITDAR margin	22.2%	22.1%	23.8%	24.8%
SaD/EBITDAR (x)	15.0	11.8	12.2	11.8
FFO/ SaD	5.0%	6.6%	6.4%	6.7%
EBITDA/cash interest cover (x)	2.1	2.2	2.0	2.2

Source: FMTG, Scope estimates
All ratios are based on adjusted financial data.

*2018 projections believed to be conservative

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 a relatively strong project and execution risks for the group compared to a focused approach on tourism.

Aggressive growth strategy

FMTG has been rapidly expanding in recent years, as included in management's growth strategy. In 2016, total sales are likely to have grown by about 25% (reported increase of 30% for the first nine months of the past year, compared to the same period in 2015). This also led to a significant increase in EBITDAR to about EUR 22m in the period (from about EUR 17m for the first nine months of 2015), adjusting for the EUR 16m disposal proceeds recorded. FMTG's expected 2016 full-year operating margin is thus likely to expand further from its level of about 21% in 2015.

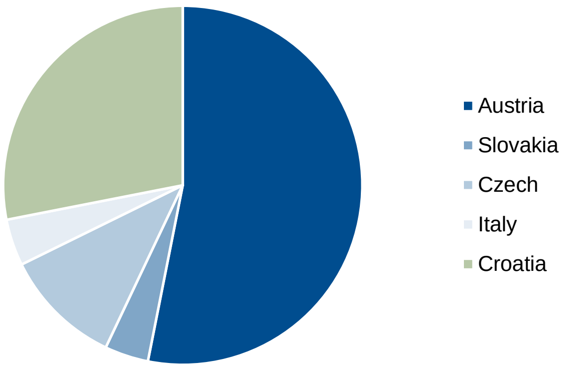
Mix of cyclical and non-cyclical industries

In Scope's view the tourism industry has largely non-cyclical characteristics (though 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 adopt a relatively cautious approach from a ratings point of view with regard to a future upside.

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 base), and the company realised more than 80% of revenues in Austria and Croatia. If management can continue to realise 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 2015



Source: FMTG, Scope Ratings

Good profitability

With much-improved operating margins of 21% in 2015 (based on EBITDAR), FMTG not only compares favourably to tourism peers, but also to much larger competitors, such as NH Hotels, or MELIA with its 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 can continue rising to about 25% in 2018, based on further sales increases and a stronger mix of higher-quality business.

Diversification slightly less than average

Scope regards FMTG's diversification to be 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.

Business risk profile: B+

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, and offset by FMTG's small absolute size as well as risks embedded in its real estate division.

Financial risk profile

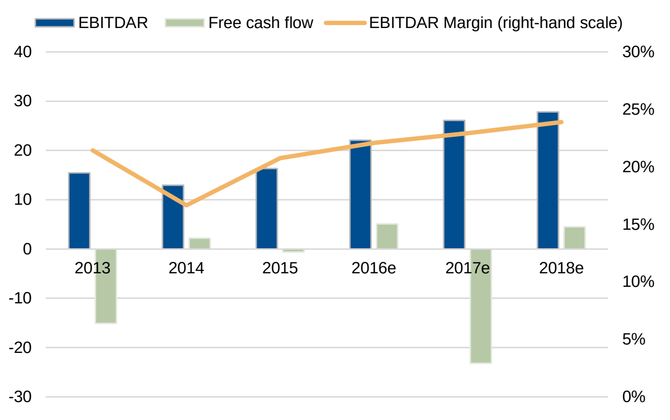
Highly leveraged balance sheet

FMTG's highly leveraged balance sheet is a direct consequence of its business mix. Management's historical focus on real estate purchases of hotel locations and the 'in-house' 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 give a wrong representation. In addition, 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.

Interest cover more meaningful

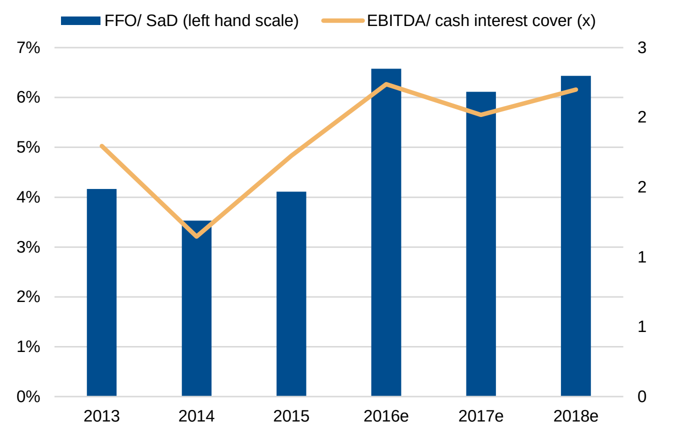
Leverage ratios such as Scope-adjusted debt (SaD) to EBITDA and FFO to SaD are still clearly in the highly leveraged area and reflect the project-related debt of FMTG's real estate business. In order to reflect more accurately the cash impact in the credit metrics of high-yield ratings, we look at the EBITDA/cash interest cover. In this regard, the levels achieved by FMTG (see 'Financial Overview' on page 2) are reflective of a B rating, even partly a B+. The relatively positive trend in the EBITDA/cash interest cover ratio since 2015 is due to bank debt being 'replaced' by leasing obligations (Figure 4).

Figure 2: Operating improvement from 2015 (EUR m)



Source: FMTG, Scope Ratings

Figure 3: Improved interest cover (EUR m)



Source: FMTG, Scope Ratings

Unusual liquidity

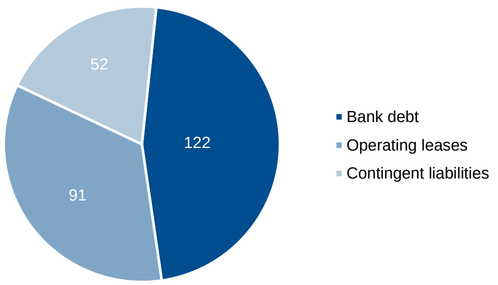
Scope regards FMTG's liquidity profile as unusual, given the seemingly large 'uncovered' portion of short-term debt of about EUR 35m (reduced in 2016 due to the repayment of the Erste Bank loan). However, as this largely pertains to project debt secured by real estate, Scope believes this effectively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

Financial risk profile: B

While the company's financial debt has decreased since 2015 as expected, it is likely to increase again during 2017 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 in connection with management's stated intention. In this respect, the transaction with Huemer Invest was instrumental. Total adjusted debt in Scope's definition also comprises operating leases of EUR 91m in 2015, expressed as a total rental charge in 2015 of EUR 9.1m multiplied by 10 (reflecting our estimate of the average length of leasing contracts). It also consists of EUR 52m contingent liabilities, which comprises guarantees and other securities.

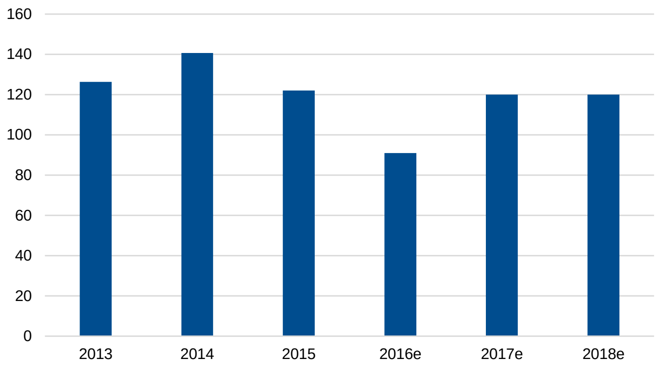
Based on the above, Scope assesses FMTG's financial risk profile as B, mainly due to presently high leverage levels and the recovering cash interest cover by EBITDA.

Figure 4: Scope-adjusted debt breakdown 2015 (figures in EUR m)



Source: FMTG, Scope Ratings

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



Source: FMTG, Scope Ratings

Outlook

Outlook: Stable

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Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

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The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Chief Executive Officer: Torsten Hinrichs, Dr Stefan Bund, Dr Sven Janssen.

Rating prepared by	**Rating committee responsible for approval of the rating**
Olaf Toelke, Lead Analyst	Werner Stäblein, Committee Chair

The rating concerns an entity, which was evaluated for the first time by Scope Ratings AG.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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☒ Detailed information provided on request
☒ Interview with the rated entity
☒ Press reports/other public information
☒ Website of the rated entity
☒ Data provided by external data providers
☒ External market reports

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Methodology

The methodology applicable for this rating (Corporate Rating Methodology) is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

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