axesor rating

Methodological Assumptions
HOTEL INDUSTRY RATING

1. Corporate Rating Framework

Axesor uses a common framework to analyze the creditworthiness of Corporates. Under the umbrella of this framework, Axesor is publishing a sector specific methodology for the Hotel Industry that is based on the Corporate framework but at the same time addresses the peculiarities of the sector. This methodology describes the risk assessments and specific factors associated with the hotel industry. All existing ratings remain unchanged.

This report serves the reader as a general guidance in understanding how both qualitative and quantitative risk factors combine and affect the final Rating result.

Axesor takes a stepped approach to rating a hotel company: First it will determine the company's business risk profile, then it will analyze its financial & economic risk profile and combine these two areas to produce a stand-alone Company Rating.

The **company's business risk profile** is assessed using the following analytic factors:

- Industry Risk
- Competitive positioning
    - Hotel portfolio and geographical diversification
    - Branding
    - Scale and market share
- Performance
- Management and shareholder quality and company's stated financial policy

The **company's financial & economic risk profile** is assessed using the following analytic factors:

- Profitability
- Cash flow and leverage
- Liquidity and solvency

In both profiles, an assessment between 1 and 10 is given to each of the subfactors where 1 is the best valuation and 10 is the worst in terms of credit quality.

This framework will provide for each profile the factors and subfactors that are analyzed, the reason why these factors are deemed to be meaningful indicators in the rating process and a series of scorecards that are the building blocks of the final rating.

The assessment of each analytical factor and subfactor is given a weight and the final numeric rating is the result of the weighted average of the individual ratings. Therefore, the higher the weight assigned to a factor the more important it is in determining the final rating outcome.

In the case of the quantitative analysis, a set of meaningful ratios are indicated for each analyzed area. Axesor provides a scale that assigns the different values of the ratios to each of the rating categories.

Finally, this methodology will map the numeric rating resulting from the analytical process into the scale "Axesor Long-Term Credit Scale" (available for consultation on the website). In addition, the rating is accompanied by an outlook (over the next year) depending on the prospects of both the sector and the performance of the company (Outlook Methodological is available on the website).

2. Scope

This methodology applies to companies that operate in the hotel industry.

Hotel companies covered by this analytical framework fall mainly under three categories:

- **Luxury hotels (five-star hotels or higher).** Hotels that offer the highest standards in the quality of its services. These hotels provide all the modern facilities for accommodation and recreation in the premium-end of the hospitality market.
- **High-to-Mid-priced hotels (four and three-star hotels).**
  Four-star hotels provide all modern amenities to travelers that manage a relatively high budget. Quality of services is almost as high as five-star hotels. Three-star hotels are mainly economy class hotels located in the bigger and smaller cities and catering to the needs of budget travelers. Offering a lower level of amenities and facilities, these hotels are value for money and offer good accommodation and related services at a reduced price.
- **Low cost hotels (two and one-star hotel or less).**
  Two-star hotels provide all the basic facilities needed for general accommodation and offer the lowest prices.
  One-star hotels offer the most basic facilities, small number of room's and locations in the city outskirts or far away from the beaches or other attractions. These hotels are the best choice for customers that are looking for the cheapest available accommodation.

3. Qualitative Factors Analysis

Factors that are taken into consideration when calculating the business profile score are:

- **Industry Risk.** In determining the business risk profile, the industry in which a company operates is a significant factor since the strengths and weaknesses of the sector are common in differing degrees to the companies that have to operate in it. The operating conditions in which a company conducts its business is strongly influenced by the sector and therefore has a strong bearing over a company's capacity to generate cash flows in order to service its debt. The sector score provides a reference point for the total rating of a company however it does not act as a ceiling for all companies belonging to the sector.

- **Competitive positioning**
    - Hotel portfolio and geographical diversification
    - Branding
    - Scale and market share
- **Performance**
- **Management and shareholder quality and company's stated financial policy**

Each factor has established a weight in the final score of the business profile, as indicated in the following table:

Business Risk Profile	
	Weight
Industry Risk	**10%**
Competitive Positioning	**20%**
Quality hotel portfolio and geographical diversification	10%
Branding	5%
Scale & Market Share	5%
Perfomance	**10%**
Management, Financial Policy and Shareholder	**10%**

4. Quantitative Factors Analysis

The strength of a company's balance sheet, its economic performance and its ability to generate cashflow in order to repay its debt are crucial aspects that must be assessed to determine the Financial & Economic Risk Profile (FERP) of an issuer.

Axesor rates FERP using a quantitative approach through the use of a series of meaningful financial ratios and through a comprehensive analysis of the company's main financial accounts. Axesor scores the following areas

- Profitability
- Cash flow and leverage
- Solvency and liquidity

As mentioned, these areas will be analyzed combining ratio and financial account analysis. Thus, Profitability will be rated according to the corresponding ratios and an in-depth analysis of the P&L account. Similarly, Cash Flow will be rated according to the selected ratios and an in-depth analysis of the Cash Flow statement account. Finally, Solvency and Liquidity will be rated applying the Loan to Value ratio and an in-depth analysis of the Balance Sheet account.

4.1. Profitability

Profitability has been selected as a meaningful indicator because it portrays how efficient the company's operations are especially when compared to its peers. A profitable company will have a higher cushion when facing a period of falling margins and will usually be amongst the first to initiate sector recovery. Higher margins also allow a company to lead the market in terms of marketing and I&R costs and also the ability to attract talent through higher wages.

4.2 Cash flow debt and Leverage

Cash flow debt coverage is at the core of any Rating assessment since it is measuring the ability of the company to repay its debt in a timely fashion.

Cash flow interest coverage is used in financially more stressful periods in which a company is not expected to repay debt but must at least meet interest payments with a fair amount of leeway. When this ratio becomes weak it is signaling a much greater problem vs a weak cash flow debt coverage.

Net financial debt over EBITDA shows the ability of the company to pay back its debt with its generated EBITDA.

4.3 Liquidity and Solvency

Solvency is a key measure of the strength of a company's Balance Sheet in terms of withstanding prolonged periods of low margins and even losses. Low loan to value ratio indicates that the value of a company's assets is comfortably greater than its liabilities.

While solvency indicates the medium-term viability of a company, liquidity measures its ability, in the short term, to honor its financial obligations. Often a solvent company can survive a liquidity shocks, but a company's liquidity will rapidly deteriorate if it has a low solvency.

Each of the ratios mentioned above will be calculated as the average value of the last two years and the projected next two years.

As mentioned before, valuation given to the four Financial Risk Profile areas can be modified by Axesor if a further analysis of the annual accounts warrants such a modification. These potential changes must be approved by the Rating Committee.

4.4 Financial & Economic Factors and their score weightings

Financial and Economic Risk Profile		
	Weight	Ratios
Profitability	15%	EBITDA Mg (%)
Cash flow and Leverage	10%	NFD/EBITDA (x)
	5%	FFO/NFD (%)
	10%	EBITDA/Interests (x)
Solvency and Liquidity	10%	Loan To Value (%)

This document updates the previous version while preserving its original methodological assumptions; therefore, all existing ratings remain unchanged. In this version, the format has been updated.