

Country
Malta

Sector
Hospitality and Real Estate

Company
AX Investments p.l.c.



Date:
27th February 2019

Credit Opinion
Positive

Company Information

The principal activity of AX Investments p.l.c. (the “Company”) is to carry on the business of a finance and investment company within the AX Group. AX Holdings Limited (the “Guarantor” or “Group”) is engaged in the provision of hospitality and entertainment services, operates a health care and retirement home and is also involved in construction and property development industries in Malta.

6% AX 2024
Price (as at 26/02/19): €111.85
YTM: 3.39%
Recommendation: Hold

Hospitality and Entertainment

The Group’s hospitality division encompasses its hotel operations and catering establishments. This division comprises of four main operating hotels; the Palace Hotel, the Victoria Hotel, the Seashells Resort at Suncrest and the Sunny Coast Resort & Spa. The Group also operates two restaurants under the commercial name ‘Tal-Kaptan’. This segment is the principal contributor to the Group’s turnover and asset base.

Construction

Construction is another principal activity of the Group and relates to civil engineering works, turnkey assignments and project management. The Group also specialises in restoration works and has to date completed various restoration projects on a number of buildings in Malta.

Property development

The property development division is responsible to identify and acquire appropriate sites for development and commercial purposes. Additionally, rental income represents proceeds derived from the leasing of Group properties to third parties.

Health care

In 2015 the Group opened the Hilltop Gardens Care Home and Residences located in the Simlija area of Naxxar, consisting of a nursing home and private residences in the form of self-catering apartments.

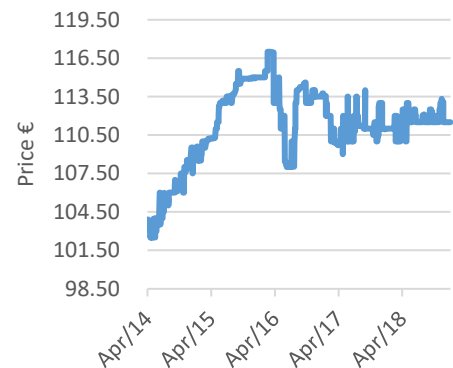
Valletta Cruise p.l.c.

The Group has recently increased their holding in Valletta Cruise p.l.c. from 14% to 36% for a total consideration of €3.93 million.

Bond issue:

In February 2014, the Company issued a 6% €40 million unsecured bond redeemable in 2024, which proceeds were used to finance:

- The redemption of the outstanding 6.7% €11.6 million bonds
- The development of the Hilltop Gardens Care Home & Residences
- The repayment of certain outstanding loans and general corporate funding purposes



Source: Bloomberg

Market Research



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Recent developments and current projects pipeline:

Name	Description	Completion date	Capex (€' million)
Saint John Boutique Hotel	The conversion of a 19-room boutique hotel in Merchant Street, Valletta	Q3 2017	4.5
27-room Boutique Hotel	The conversion of a 27-room, boutique hotel in Merchant Street, Valletta	Q1 2019	6.0
Targa Gap Complex, Mosta	Development of an office block, a showroom, parking facilities and a residential block of apartments	Q1 2020	6.5
Refurbishment	The refurbishment of a hotel in Sliema	Undisclosed	Undisclosed

Source: Company's Audited Financial Statements and Company's Financial Analysis Summary 2018

SWOT Analysis

Strengths

- ✓ The Group operates a portfolio of five hotels with a history of positive financial results and cash generation.
- ✓ The Group is successful in identifying appropriate sites for development and in applying its know-how of the construction industry to develop those sites.
- ✓ Uniquely positioned in the Cruises sector via its shareholding in Valletta Cruise Port plc, which is a healthy cash contributor.
- ✓ Comparatively low financial leverage. Net debt / Equity for FY 2018 stands at 22.9%.
- ✓ Constant improvement in company fundamentals.

Weaknesses

- ✗ No geographical diversification. The Group is highly dependent on the tourism and real estate industry in Malta.
- ✗ The Group operates in capital intensive industries.

Opportunities

- Tourism in Malta has, in recent years, been performing at a strong level. The continued national investment in the sector should have positive ripple effects.
- Expansion in the hotel segment, with the recent opening of a new boutique hotel in Valletta and another expected for 2019 should contribute towards higher and more stable profitability and cash flows.
- During 2017, the Group was granted planning permits for the Targa Gap Complex in Mosta. The development of this site may positively impact the future profitability potential of the Group.

Threats

- ! Potential downturn in the tourism industry in Malta would impact the financial performance of the Group's hotel operations which is the principal contributor of the Group's revenue.
- ! A potential downturn in the Real Estate industry in Malta.
- ! Highly competitive hospitality industry in Malta.

Financial Summary

For the financial years ending 31 st October	Audited 2016	Audited 2017	Audited 2018
	€	€	€
Income statement			
Revenue	38,030,042	45,852,010	56,466,680
Other operating income	30,445	305,035	309,099
Other operating charges	(13,016,891)	(16,158,454)	(19,576,628)
Labour costs	(12,377,788)	(14,631,463)	(16,251,687)
EBITDA	12,665,808	15,367,128	20,947,464
Depreciation and amortisation	(4,824,902)	(5,238,416)	(5,347,867)
EBIT	7,840,906	10,128,712	15,599,597
Share of results of associates	696,495	1,087,141	1,034,632
Revaluation of investment property	900,000	5,811,458	26,588,506
Net finance costs	(3,485,747)	(3,449,156)	(3,005,710)
Profit before tax	5,951,654	13,578,155	40,217,025
Income tax	(1,918,250)	(1,673,900)	(8,259,397)
Net income	4,033,404	11,904,255	31,957,628
Cash flow			
Net cash from operations (CFO)	16,600,982	16,835,990	15,845,558
Capex	(12,497,449)	(13,251,326)	(4,891,171)
Free cash flows (CFO – Capex)	4,103,533	3,584,664	10,954,387
Balance sheet			
Inventory	2,720,657	2,971,100	2,369,512
Cash and cash equivalents	5,875,681	7,353,057	6,852,381
Current assets	20,671,731	24,164,825	22,268,440
Non-current assets	249,752,793	262,152,845	302,974,778
Total assets	270,424,524	286,317,670	325,243,218
Current liabilities	24,408,907	29,296,852	21,218,005
Non-current liabilities	82,296,601	83,697,547	89,435,167
Total liabilities	106,705,508	112,994,399	110,653,172
Total Financial debt ¹	67,814,126	67,004,520	55,241,756
Net debt	61,938,445	59,651,463	48,389,375
Total equity	163,719,016	173,323,271	214,590,046
Ratios			
EBITDA margin (EBITDA / Revenue)	33.3%	33.5%	37.1%
Operating (EBIT) margin (EBIT / Revenue)	20.6%	22.1%	27.6%
Net margin (Net income / Revenue)	10.6%	26.0%	56.6%
Return on common equity	2.9%	7.1%	16.5%
Return on assets	1.5%	4.2%	9.8%
Current ratio (Current assets / Current Liabilities)	0.8x	0.8x	1.0x
Quick ratio (Current assets less Inventory / Current Liabilities)	0.7x	0.7x	0.9x
Interest coverage ratio (EBITDA / Cash interest paid)	3.6x	4.5x	6.9x
Gearing level 1 (Net debt / Total equity)	38.8%	35.3%	22.9%
Gearing level 2 (Total Liabilities / Total Assets)	39.5%	39.5%	34.0%
Net debt / EBITDA	5.0x	4.0x	2.3x

Source: Company's Audited Financial Statements

¹ Total financial debt excludes non-interest bearing debt or debt with no fixed date of maturity. These comprise of amounts owed to other related parties, shareholder's loan and other payables.

Investment Considerations

- **Revenue**

Revenue generated from AX Holdings Ltd increased by €10.6 million, or 23.1% from €45.9 million in 2017 to €56.5 million in 2018. As illustrated in the table below, all the segments of the Group have contributed towards such growth in revenue.

Revenue by segment	2017 €	2018 €	Increase in %
Hospitality and entertainment	35,743,666	39,495,143	10.5%
Construction	5,502,976	8,146,435	48.0%
Sale of property and rental income	587,948	2,840,255	383.1%
Healthcare	3,124,010	4,763,261	52.5%
Dividend receivable	893,410	1,221,586	36.7%
Total Revenue/ Growth	45,852,010	56,466,680	23.1%

Source: Company's Audited Financial Statements

The hospitality and entertainment segment is the largest contributor towards the Group's revenue, consisting of activities conducted by their four main operating hotels; the Palace Hotel, the Victoria Hotel, the Seashells Resort at Suncrest and the Sunny Coast Resort & Spa. Revenue under this segment has also been boosted through the rebranding exercise of the two restaurants under the commercial name 'Tal-Kaptan'. Revenue generated from the provision of hospitality and entertainment services increased by €3.8 million, or 10.5% from €35.7 million in 2017 to €39.5 million in 2018, primarily due to the recently acquired 19-room Saint John's Boutique Hotel in Merchant Street, Valletta.

Revenue generated under the construction segment increased by €2.6 million, or 48% from €5.5 million in 2017 to €8.1 million in 2018. This upsurge in revenue from construction and development services was primarily driven by an increase in turnkey project engagements and restoration projects undertaken by the Group.

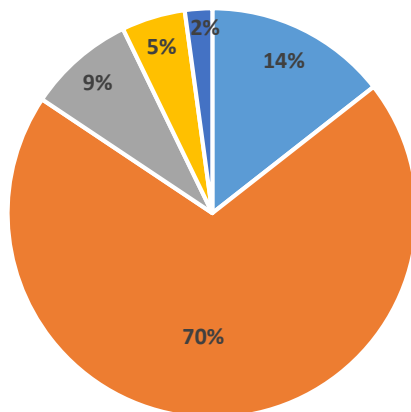
The property development, sale of property and rental income segment also registered a positive year, reaching a total revenue of €2.8 million in 2018, signifying an increase of €2.2 million over 2017. This improvement was mainly initiated through the sale of a warehouse in Burmarrad as well as another plot in Mosta. Such increase was also derived from the renting out of a convenience shop and a child care centre situated at Simblija Care Home and Hilltop Gardens Retirement Village.

Further growth in revenue was registered by the Group through the health care segment. Consequent to an increase in occupancy rate relating to both the self-catering residential units and the nursing home, the overall revenue under this segment increased by €1.6 million, or 52.5% from €3.1 million in 2017 to €4.8 million in 2018.

As part of their revenue stream the Group reports a line item entitled 'dividend receivable' which is attributable to the shareholding in Valletta Cruise Port plc. Over the years this has proved to be a profitable investment and a cash contributor due to annual distribution of dividends. However, it is important to note that it doesn't form part of their core operations.

Overall, we expect the Group to continue to benefit from the positive outlook of the Maltese economy and also expect the Group to continue to reap out the benefits from the investments which are carried out on a frequent basis.

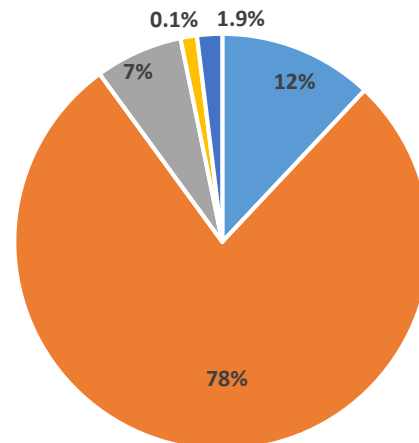
Revenue by segment 2018



- Construction
- Hospitality and entertainment
- Healthcare
- Sale of property and rental income
- Dividend receivable

Source: Company's Audited Financial Statements

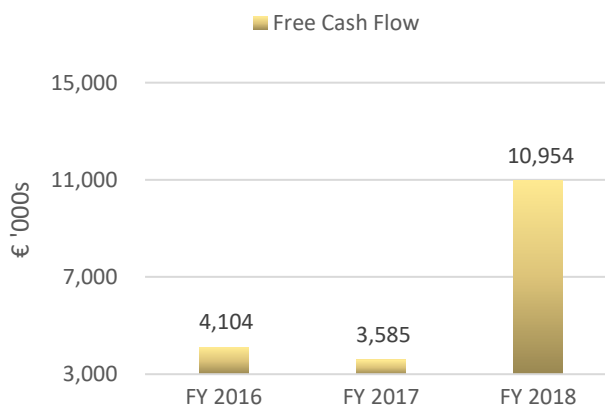
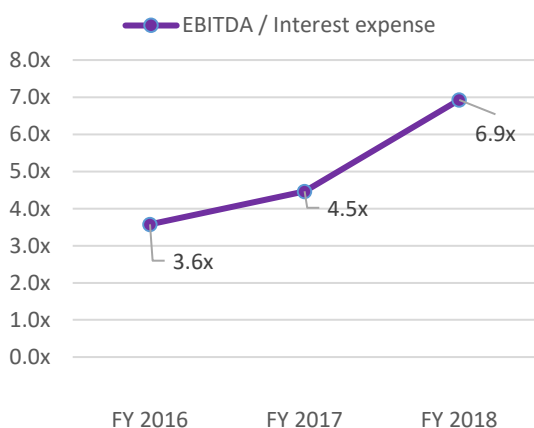
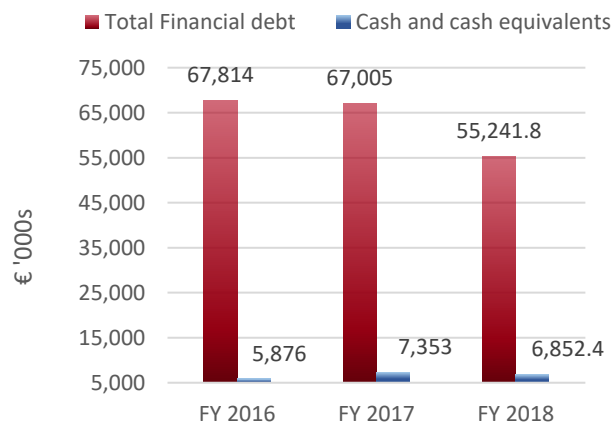
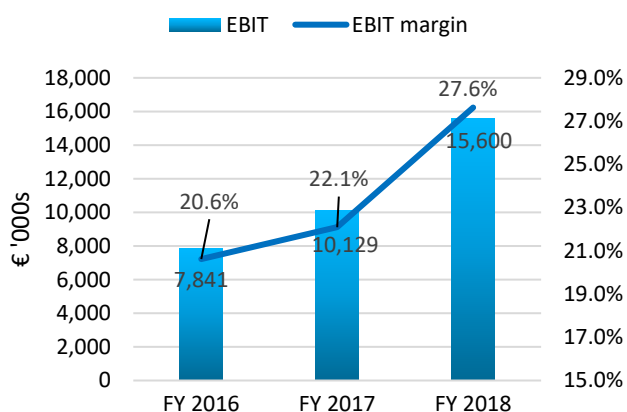
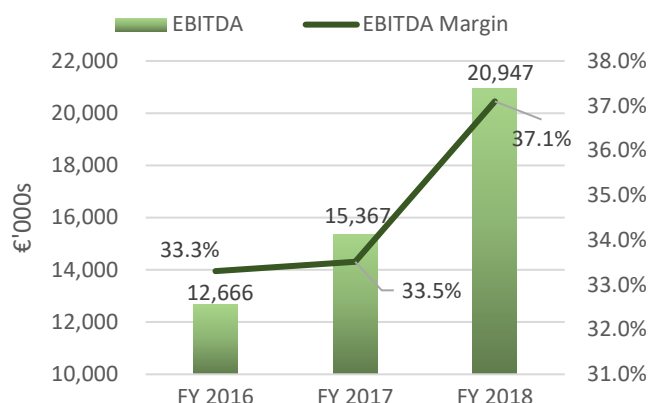
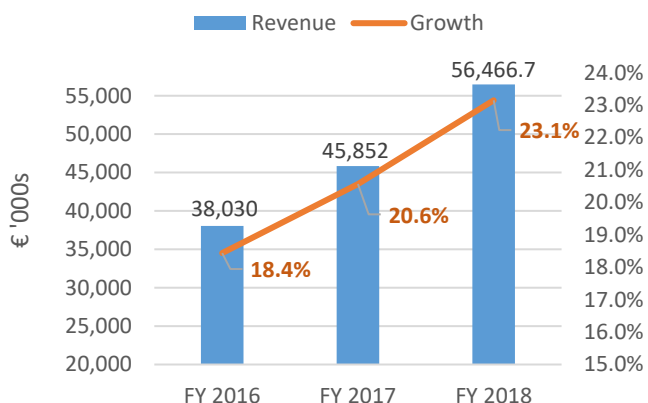
Revenue by segment 2017



- Construction
- Hospitality and entertainment
- Healthcare
- Sale of property and rental income
- Dividend receivable

Source: Company's Audited Financial Statements

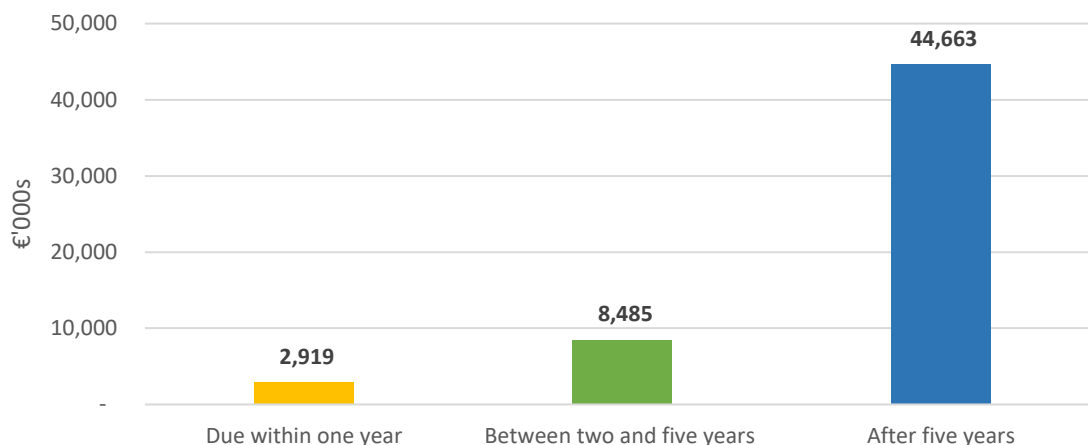
- **Expenses** - Operating expenses, increased by €5.0 million or 16.5% from €30.5 million in 2017 to € 35.5 million in 2018. Such increase in expenses is deemed to be in line with the higher activity conducted by the Group.
- **EBITDA factors**
 - Due to higher revenue generated by the Group, EBITDA increased by €5.6 million or 36% from €15.4 million in 2017 to €20.9 million in 2018.
- **EBITDA Margin** – Following the Group's positive performance with the prime contributor being from the hospitality sector, the Group's EBITDA margins improved from 33.5% in 2017 to 37.1% in 2018.
- **EBIT Margin** – The Group also registered an improvement in EBIT margin of 5.5% from 22.1% in 2017 to 27.6% in 2018.
- **Interest Cover** – During 2018 the Group managed to settle in full a loan of €6.7 million payable to Malta Enterprise. This has resulted into a lower interest expense which consequently improved interest coverage from 4.5x in 2017 to 6.9x in 2018. This has also resulted into the Group incurring lower finance costs for the year.
- **Net Income** – Net income for the year under review amounted to €31.9 million, an increase of €20.1 million when compared to the previous financial year. Nonetheless, in the year the company recorded a one-time positive movement in investment property revaluation amounting to €26.6 million, which positively impacted the net income and subsequently boosted equity.
- **Net Margin** – Net margin in 2018 is relatively high due to the positive movement in investment property revaluation. Excluding this revaluation movement, the net margin stands at 9.5%.
- **Income Tax** – The income tax charge for the year was of €8.3 million out of which €4.2 million relate to a deferred tax expense due to the property revaluation as discussed above.
- **Capex** - Following the completion of the development of the Saint John Boutique Hotel, capex decreased to €4.9 million in 2018 from €13.3 million in 2017.



Source: Company's Audited Financial Statements

Debt Maturity Profile

Total Borrowings (2018)



Source: Company's Audited Financial Statements

Debt Analysis	2017	2018
	€	€
Bank borrowings	21,081,624	15,785,417
Other financial liabilities	8,048,508	826,208
Debt securities in issue	39,394,010	39,456,339
Total Financial Debt	68,524,142	56,067,964

Source: Company's Audited Financial Statements

- The Group has bank facilities of €15,726,468 which are secured by general hypothecs over the Group's assets, by special hypothecs over various immovable properties, by pledges over various insurance policies, and by personal guarantees of the Group's chairman. Bank borrowings also include bank overdrafts and balances overdrawn.
- Other financial liabilities mainly comprise of amounts owed to other related parties, shareholder's loan and other payables.
- The shareholder's loan is unsecured, interest free and has no fixed date of repayment.
- In line with the 2014 bond issue prospectus, the Group settled in full a loan of €6.7 million payable to Malta Enterprise. This is reflected through the sharp decline in other financial liabilities illustrated in the table above.
- In 2014, the Group issued an unsecured bond of a notional value of €40 million redeemable in 2024.
- The bonds have a coupon rate of 6% per annum.

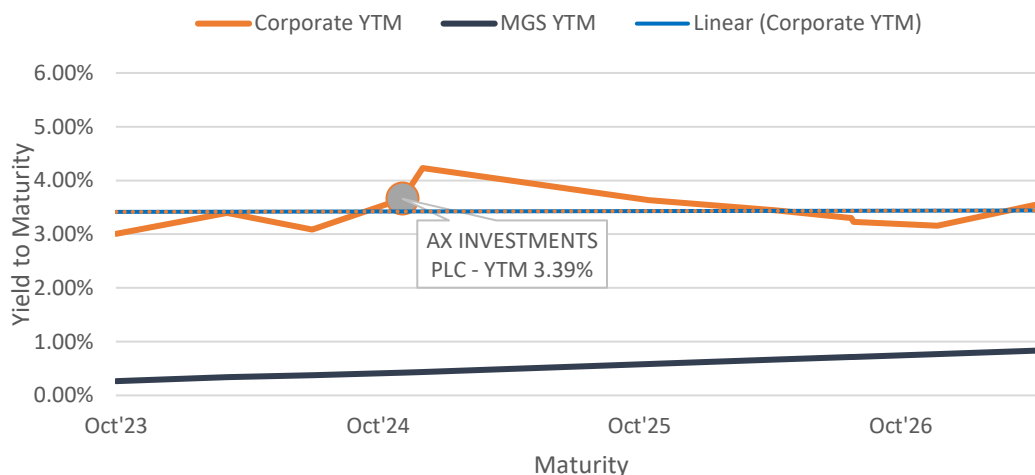
	Bank Borrowings	Bond
Average annual interest rate:	3.9% - 5.1%	6%

Analysis of outstanding issues

Security	Yield to Maturity (%)	Interest coverage (EBITDA) (times)	Total Assets (€'millions)	Total Equity (€'millions)	Total Liabilities / Total Assets (%)	Net Debt / Total Equity (%)	Net Debt / EBITDA (times)	Current Ratio (times)	Return on Common Equity (%)	Net Margin (%)	Revenue Growth (YoY) (%)	Last Closing Price
6% AX Investments Plc € 2024	3.39%	6.9	325.24	214.59	34.0%	22.9%	2.3	1.1	16.5%	56.6%	23.1%	111.85
4% Eden Finance plc Unsecured € 2027	3.41%	4.5	169.94	90.16	46.9%	57.5%	5.0	0.7	3.1%	7.8%	16.6%	104.10
5.3% Mariner Finance plc Unsecured € 2024	3.09%	4.4	77.09	38.70	49.8%	83.9%	3.4	2.0	17.6%	36.2%	11.1%	110.74
4% MIDI plc Secured € 2026	3.30%	(.9)	0.24	0.09	63.2%	64.7%	(25.3)	2.4	27.0%	448.1%	-46.5%	104.50
3.75% Premier Capital plc Unsecured € 2026	3.16%	8.0	161.13	47.61	70.5%	133.1%	1.8	1.0	35.6%	6.0%	14.5%	104.00
5% Hal Mann Vella Group plc Secured Bonds € 2024	3.66%	3.1	107.80	39.81	63.1%	117.4%	10.6	1.3	12.8%	24.9%	65.8%	106.76
5.1% 1923 Investments plc Unsecured € 2024	4.23%	1.5	118.49	33.71	71.5%	156.5%	13.4	1.0	-3.5%	-0.7%	12.9%	104.35
4.5% Hili Properties plc Unsecured € 2025	3.63%	1.5	135.88	38.36	71.8%	232.8%	19.9	0.5	10.1%	53.1%	30.9%	105.00
4.25% GAP Group plc Secured € 2023	3.01%	2.6	56.91	6.70	88.2%	570.3%	13.2	3.3	9.2%	3.9%	1.2%	105.25
4.35% SD Finance plc Unsecured € 2027	3.59%	5.5	217.60	65.70	69.8%	92.1%	3.2	0.3	11.0%	14.5%	9.3%	105.25
4% Stivala Group Finance plc Secured € 2027	3.44%	9.5	179.73	100.12	44.3%	55.8%	8.3	1.6	59.9%	483.9%	29.2%	104.10
4.25% Corinthia Finance plc Unsecured € 2026	3.45%	2.6	1,765.07	901.60	48.9%	67.9%	8.5	1.0	0.7%	2.0%	40.0%	105.00
4% International Hotel Investments plc Secured € 2026	3.23%	2.7	1,602.32	884.63	44.8%	57.1%	7.9	1.5	1.9%	6.1%	53.5%	105.00
Average	3.43%	3.7	382.7	187.3	61.1%	140.8%	5.8	1.4	15.46%	90.49%	19.9%	

Source: MSE and Company's Audited Financial Statements

Yield Curve Analysis



Source: Central Bank of Malta and Bloomberg

Investment Rationale:

We have compared AX Investments plc securities against similar issuers in the local market. Comparable companies were specifically identified on the basis of the maturity of their bonds and the industry in which they operate. The credit profile of the comparable companies was analysed in terms of leverage and the ability to meet debt obligations.

The Group’s overall risk profile is lower in comparison to its peers as evidenced by its leverage position (Total Liabilities/Total Assets: AX 34% vs average 61.1% and Net Debt/Equity: AX 22.9% vs average 140.8%). The Group has also outperformed its’ peers in terms of interest coverage (Interest cover: AX 6.9x vs average 3.7x). The latest results indicate that the Group has very little concern about the ability to service its debt and has very favourable credit metrics. On this basis we are issuing a **Positive** credit opinion on this issuer.

The current Yield to Maturity (YTM) of the Group’s bond (3.39%) is similar compared to the securities issued by all peers in the maturity bucket (3.43%). We believe that the current levels justify a **Hold** recommendation, given the already tight spreads at which the bond price is trading.

Glossary and Definitions

Income Statement	
Revenue	Total revenue generated by the Group/Company from its principal business activities during the financial year.
Costs	Costs are expenses incurred by the Group/Company in the production of its revenue.
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. It reflects the Group's/Company's earnings purely from operations.
Operating Profit (EBIT)	EBIT is an abbreviation for earnings before interest and tax.
Depreciation and Amortisation	An accounting charge to compensate for the decrease in the monetary value of an asset over time and the eventual cost to replace the asset once fully depreciated.
Net Finance Costs	The interest accrued on debt obligations less any interest earned on cash bank balances and from intra-group companies on any loan advances.
Net Income	The profit made by the Group/Company during the financial year net of any income taxes incurred.
Profitability Ratios	
Growth in Revenue (YoY)	This represents the growth in revenue when compared with previous financial year.
EBITDA Margin	EBITDA as a percentage of total revenue.
Operating (EBIT) Margin	Operating margin is the EBIT as a percentage of total revenue.
Net Margin	Net income expressed as a percentage of total revenue.
Return on Common Equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Return on Assets	Return on assets (ROA) is computed by dividing net income by total assets.
Cash Flow Statement	
Cash Flow from Operating Activities (CFO)	Cash generated from the principal revenue producing activities of the Group/Company less any interest incurred on debt.
Cash Flow from Investing Activities	Cash generated from the activities dealing with the acquisition and disposal of long-term assets and other investments of the Group/Company.
Cash Flow from Financing Activities	Cash generated from the activities that result in change in share capital and borrowings of the Group/Company.
Capex	Represents the capital expenditure incurred by the Group/Company in a financial year.
Free Cash Flows (FCF)	The amount of cash the Group/Company has after it has met its financial obligations. It is calculated by taking Cash Flow from Operating Activities less the Capex of the same financial year.
Balance Sheet	
Total Assets	What the Group/Company owns which can be further classified into Non-Current Assets and Current Assets.
Non-Current Assets	Assets, full value of which will not be realised within the forthcoming accounting year
Current Assets	Assets which are realisable within one year from the statement of financial position date.

Inventory	Inventory is the term for the goods available for sale and raw materials used to produce goods available for sale.
Cash and Cash Equivalents	Cash and cash equivalents are Group/Company assets that are either cash or can be converted into cash immediately.
Total Equity	Total Equity is calculated as total assets less liabilities, representing the capital owned by the shareholders, retained earnings, and any reserves.
Total Liabilities	What the Group/Company owes which can be further classified into Non-Current Liabilities and Current Liabilities.
Non-Current Liabilities	Obligations which are due after more than one financial year.
Total Debt	All debt obligations inclusive of long and short-term debt.
Net Debt	Total debt of a Group/Company less any cash and cash equivalents.
Current Liabilities	Obligations which are due within one financial year.
Financial Strength Ratios	
Current Ratio	The Current ratio (also known as the Liquidity Ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares current assets to current liabilities.
Quick Ratio (Acid Test Ratio)	The quick ratio measures a Group's/Company's ability to meet its short-term obligations with its most liquid assets. It compares current assets (less inventory) to current liabilities.
Interest Coverage Ratio	The interest coverage ratio is calculated by dividing EBITDA of one period by cash interest paid of the same period.
Gearing Ratio	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets.
Gearing Ratio Level 1	Is calculated by dividing Net Debt by Total Equity.
Gearing Ratio Level 2	Is calculated by dividing Total Liabilities by Total Assets.
Net Debt / EBITDA	The Net Debt / EBITDA ratio measures the ability of the Group/Company to refinance its debt by looking at the EBITDA.
Other Definitions	
Yield to Maturity (YTM)	YTM is the rate of return expected on a bond which is held till maturity. It is essentially the internal rate of return on a bond and it equates the present value of bond future cash flows to its current market price.

Explanation of Ratings

Credit Opinion

Positive indicates expectations of a general improvement of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Neutral indicates expectations of a general stable trend of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Negative indicates expectations of a general deterioration of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Issue specific recommendations

The recommendations below are with respect to existing debt securities issued on the Malta Stock Exchange.

Buy indicates our favourable view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

Hold indicates our neutral view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

Sell indicates our negative view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

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